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Politics this week

Feb 7th 2002
From The Economist print edition

Budgeting for security

President George Bush submitted a $2.13 trillion budget to Congress. It included the biggest rise in military spending since 1982 and allocated several billion dollars to protect the United States from biological terrorism. Senate Democrats blocked his plan to stimulate the economy.

See article: A new budget

George Tenet, the director of the CIA, warned the Senate intelligence committee that the leaders of **al-Qaeda** were working “to reconstitute the organisation and resume its terrorist operations”.

John Walker, an American who fought for the Taliban, was indicted by a federal grand jury for “ten serious crimes”, including five conspiracy charges. He was denied bail, despite his lawyers' claim that his statements were made under “highly coercive conditions”.

Colin Powell told a Senate committee that the United States would be willing to sign “something legally binding” with Russia to limit each country's stocks of strategic nuclear weapons.

See article: America, nuclear weapons and proliferation

Europe at odds

Some European governments broke openly with **George Bush** over his policy in the Middle East. The EU would co-operate as much as possible with Iran on trade and against terrorism, said Spain's foreign minister. And France's sharply attacked America for its “simplistic” approach to terrorism and its “blind” acceptance of “Ariel Sharon's policy of pure repression”. Even Britain voiced some unease.

Didier Schuller, a French conservative politician who had fled to the Caribbean seven years ago, returned to face **corruption** charges. This may hurt the re-election chances of President Jacques Chirac.

See article: Bad news for France's president

Countries in **Central Europe** hoping to join the EU complained that the terms for farming aid offered last week by the European Commission were too mean.

See article: Poland's angry farmers and the EU

Monarchists took heart: on February 6th **Queen Elizabeth II** notched up 50 years on Britain's throne. The Dutch cheered as their crown prince, Willem Alexander, married an Argentine, Maxima Zorreguieta. Italy's royalists were in two minds: before the Senate voted to let male members of the once royal Savoy family back into Italy, the heir to the ex-throne promised loyalty to the republican constitution.

See article: Europe's doggedly durable royals

The government of **Cyprus** accused Turkey of landing fresh tanks in the breakaway north of the island. Nonsense, said the Turks. True or false, no help to the talks now under way between the leaders of the

island's rival communities.

Search for Pearl

Police searching for **Daniel Pearl**, an American reporter kidnapped in Pakistan, raided a dozen houses in Karachi, where he was last seen. Six suspects were detained. A police chief in Islamabad said he believed Mr Pearl was alive.

Thousands of chickens were slaughtered in **Hong Kong** in a move to stop the spread of a bird flu that killed six people in 1997.

In a new outbreak of kidnapping in the **Philippines**, a South Korean and a Filipino businessman were seized by gunmen in the southern island of Mindanao. Police, helped by American special forces, continued to hunt for an American missionary couple and a Filipina nurse held on Basilan island.

South Korean MPs presented a letter to the American embassy in Seoul while protesting that George Bush's inclusion of North Korea in an “axis of evil” could destabilise the Korean peninsula.

See article: The Koreas and the United States

Inspecting Iraq

Saddam Hussein conveyed a message to Kofi Annan, through Amr Moussa, the Arab League's secretary-general, that Iraq was ready to talk to the UN with everything on the table. Mr Annan said he would meet an Iraqi delegation. America insists that talks be restricted to the return of UN arms inspectors.

Ariel Sharon, Israel's prime minister, met three high-ranking Palestinian officials on the eve of a visit to the United States that comes at a time when Israeli-American thinking is in harmony both on George Bush's “axis of evil” and the Israeli-Palestinian conflict. In a small sign of Israeli divergence, some army reservists have refused to serve in the occupied territories.

See article: Israel and America

Several days of fighting between Yorubas and Hausas in Lagos, **Nigeria's** commercial capital, led to about 100 deaths. Tony Blair, Britain's prime minister, arrived in Nigeria at the start of a four-nation West African tour that also takes in Ghana, Senegal and Sierra Leone.

See article: Tony Blair

EU observers said that results from **Zambia's** general election, held in December, were seriously flawed and may not represent voters' wishes.

Robert Mugabe agreed to let in an EU team to monitor **Zimbabwe's** election next month. In response the EU decided to hold off from imposing targeted sanctions. A separate team of observers from the Commonwealth will be led by Abdulsalami Abubakar, a former Nigerian head of state.

Belgium apologised, for the first time, for the 1961 murder of **Patrice Lumumba**, Congo's independence leader and first prime minister. A Belgian parliamentary commission had concluded that Belgium bore moral responsibility for his killing by Congolese rivals.

The UN's legal counsel told the Security Council that Morocco had no right to issue oil-exploration rights in **Western Sahara** without the consent of Western Saharans. This puts in doubt two deals signed with French and American companies last year.

The Colleges of Medicine of South Africa added its authoritative voice to many others criticising the government for delays in providing the anti-AIDS drug **Nevirapine** to pregnant women.

Argentina's new plan

Troubled **Argentina** unveiled a new economic plan, including a full float for the devalued peso and a conversion of all dollar bank loans into pesos at the pre-devaluation rate. A freeze on access to savings, which have halved in worth in dollar terms since the devaluation, was partly lifted after the Supreme Court overruled it. Argentina's president, Eduardo Duhalde, meanwhile presented a lean budget, cutting spending by 6% and foreseeing a 5% fall in GDP.

See article: Argentina's new economic plan

The **World Social Forum** held a lively and disorganised meeting in Porto Alegre, Brazil. Some 51,000 delegates attended, three times more than last year.

See article: The World Social Forum

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Business this week

Feb 7th 2002
From The Economist print edition

Rogue trader

Allied Irish Banks is investigating a suspected fraud perpetrated by a foreign-exchange trader at its American subsidiary, Allfirst, that could cost it $750m. AIB denied that the losses put the bank's future in doubt.

See article: Allied Irish Banks

An **Enron-**appointed committee released a damning report on the company's abuse of off-balance-sheet financing. Meanwhile, Kenneth Lay, Enron's erstwhile boss, is to be subpoenaed after refusing to appear voluntarily before congressional committees looking into the collapse of the company. Investors continued to look closely at the financial practices of other firms with questionable accounting and a heavy burden of debt.

See article: The trouble with accounting

Tyco admitted that it had spent $8 billion over three years on 700 unannounced small acquisitions, but said that the deals were not “material”. The troubled conglomerate also paid off billions of dollars of short-term commercial paper using bank credit lines. And it put off a planned flotation of its financial arm.

General Electric's shares fell as investors fretted over similarities between the complex accounting employed by the world's biggest company and that used by Tyco and Enron. Jeffrey Immelt, GE's chief executive, took the unusual step of reiterating buoyant targets for profit growth. GE's shares duly rebounded.

Accounting woes hit **Elan**, an Irish drug company. Its shares fell by 50% in a single day after it conceded that profits for its latest year would have been considerably lower had it included two off-balance-sheet entities not included in its American accounts.

Invensys, a British electronics firm, blamed a slipping share price on the Enron effect and denied that its heavy indebtedness would force a rights issue. **ICI**, a British chemicals giant, raised £800m ($1.1 billion) with a rights issue but conceded that more action would be needed to reduce debt further.

Problems mounted for **Kirch**, a cash-strapped German media company. It emerged that Dresdner Bank was unlikely to extend an April deadline for repayment of a *euro*460m ($400m) loan. Meanwhile, Kirch's biggest lender, Bayerische Landesbank, urged fellow creditors to co-operate on a rescue that would keep Kirch in German hands.

Highly productive

Productivity in America rose by 3.5% at an annual rate in the fourth quarter. But it grew by a more modest 1.6% over the fourth quarter a year ago.

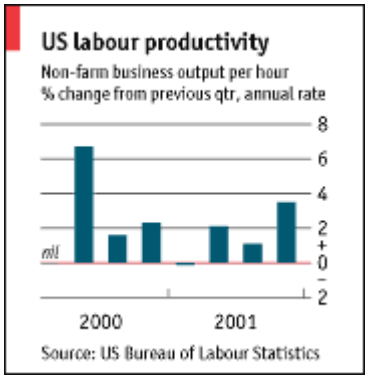
See article: American productivity

Germany's jobless numbers soared to 4.3m, far above the politically touchy 4m mark; even after seasonal adjustment the figure was only just

below 4m. Meanwhile, the official labour office was accused of massively inflating the number of jobs given to the unemployed.

Wim Duisenberg, the Dutch president of the European Central Bank, ended months of speculation with the announcement that he would step down in July 2003, on his 68th birthday. The French still hope to be able to nominate his successor.

See article: The European Central Bank



In descent

British Airways announced an operating loss for the latest quarter of £187m ($270m), blaming a weak world economy and the after-effects of September 11th. Further job cuts seem inevitable as the troubled airline cuts back its short-haul European routes.

Ryanair, an Irish no-frills carrier, said that net profits for its latest quarter were up by 35% compared with the same period a year ago to *euro*28.8m ($25.8m) as travellers continued to flock to low-cost airlines. It recently announced a big expansion of services and ordered 100 new aircraft from Boeing.

Driving prices down

The European Commission published its much-trailed plan to improve competition in Europe's car market. The so-called "**block exemption**" from antitrust rules is being narrowed to give garages more independence from car makers, to allow them to sell different makes on the same site and to sell across borders. Sales and servicing will also be disconnected. Consumer groups cheered; car companies winced.

A shake-up of senior management at **EMI** followed the British music group's second profit warning in the past few months. Poor sales in America and Japan were given as the reason. The company's shares fell yet again.

Arthur D. Little, America's oldest management consultancy, filed for Chapter 11 bankruptcy protection. The company will use the breathing-space to restructure prior to its acquisition, for around $71m, by Cerberus Capital Management, an investment company that is the consultancy's principal lender.

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Enron and auditing

The lessons from Enron

Feb 7th 2002
From The Economist print edition

After the energy firm's collapse, the entire auditing regime needs radical change

Get article background

THE mess just keeps spreading. Two months after Enron filed for Chapter 11, the reverberations from the Texas-based energy-trading firm's bankruptcy might have been expected to fade; instead, they are growing. On Capitol Hill, politicians are engaged in an investigative orgy not seen since Whitewater, with the blame pinned variously on the company's managers, its directors, its auditors and its bankers, as well as on the Bush administration; indeed on anybody except the hundreds of congressmen who queued up to take campaign cash from Enron. The only missing ingredient in the scandal—so far—is sex.

The effects are also touching Wall Street. In the past few weeks, investors have shifted their attention to other companies, making a frenzied search for any dodgy accounting that might reveal the next Enron. Canny traders have found a lucrative new strategy: sell a firm's stock short and then spread rumours about its accounts. Such companies as Tyco, PNC Financial Services, Invensys and even the biggest of the lot, General Electric, have all suffered. Last week Global Crossing, a telecoms firm, went bust amid claims of dubious accounts. This week shares in Elan, an Irish-based drug maker, were pummelled by worries over its accounting policies.

All this might create the impression that corporate financial reports, the quality of company profits and the standard of auditing in America have suddenly and simultaneously deteriorated. Yet that would be wide of the mark: the deterioration has actually been apparent for many years. A growing body of evidence does indeed suggest that Enron was a peculiarly egregious case of bad management, misleading accounts, shoddy auditing and, quite probably, outright fraud. But the bigger lessons that Enron offers for accounting and corporate governance have long been familiar from previous scandals, in America and elsewhere. That makes it all the more urgent to respond now with the right reforms.

Uncooking the books

The place to start is auditing. Accurate company accounts are a keystone for any proper capital market, not least America's. Andersen, the firm that audited Enron's books from its inception in 1985 (it was also Global Crossing's auditor), has been suggesting that its failings are representative of the whole profession's. In fact, Andersen seems to have been unusually culpable over Enron: shredding of incriminating documents just ahead of the investigators is not yet a widespread habit. But it is also true that this is only the latest of a string of corporate scandals involving appalling audit failures, from Maxwell and Polly Peck in Britain, through Metallgesellschaft in Germany, to Cendant, Sunbeam and Waste Management in America. In the past four years alone, over 700 American companies have been forced to restate their accounts.

At the heart of these audit failures lies a set of business relationships that are bedevilled by perverse incentives and conflicts of interest. In theory, a company's auditors are appointed independently by its shareholders, to whom they report. In practice, they are chosen by the company's bosses, to whom they all too often become beholden. Accounting firms frequently sell consulting services to their audit clients; external auditors may be hired to senior management positions or as internal auditors; it is far too easy to play on an individual audit partner's fear of losing a lucrative audit assignment. Against such a

background, it is little wonder that the quality of the audit often suffers.

What should be done? The most radical change would be to take responsibility for audits away from private accounting firms altogether and give it, lock, stock and barrel, to the government. Perhaps such a change may yet become necessary. But it would run risks in terms of the quality of auditors; and it is not always so obvious that a government agency would manage to escape the conflicts and mistakes to which private firms have so often fallen prey. As an intermediate step, however, a simpler suggestion is to take the job of choosing the auditors away from a company's bosses. Instead, a government agency—meaning, in America, the Securities and Exchange Commission (SEC)—would appoint the auditors, even if on the basis of a list recommended by the company, which would continue to pay the audit fee.

Harvey Pitt, the new chairman of the Securities and Exchange Commission, is not yet willing to be anything like so radical. He has been widely attacked because, when he acted in the past as a lawyer for a number of accounting firms, he helped to fend off several reforms. Yet he now seems ready to make at least some of the other changes that the Enron scandal has shown to be necessary (see article).

Among these are much fiercer statutory regulation of the auditing profession, including disciplinary powers with real bite. Hitherto, auditors have managed to get away with the fiction of self-regulation, both through peer review and by toothless professional and oversight bodies that they themselves have dominated. There should also be a ban on accounting firms offering (often more profitable) consulting and other services to their audit clients. Another good idea is mandatory rotation, every four years or so, both of audit partners—so that individuals do not become too committed to their clients—and of audit firms. The most effective peer review happens when one firm comes in to look at a predecessor's books. The SEC should also ban the practice of companies' hiring managers and internal auditors from their external audit firms.

In search of better standards

Then there is the issue of accounting standards themselves. Enron's behaviour has confirmed that in some areas, notably the treatment of off-balance-sheet dodges, American accounting standards are too lax; while in others they are so prescriptive that they have lost sight of broader principles. Past attempts by the Financial Accounting Standards Board to improve standards have often been stymied by vociferous lobbying. It is time for the SEC itself to impose more rigorous standards, although that should often be through sound principles (including paying less attention to single numbers for earnings) rather than overly detailed rules. It would also be good to come up with internationally agreed standards.

Although audit is the most pressing area for change, it is not the only one. The Enron fiasco has shown that all is not well with the governance of many big American companies. Over the years all sorts of checks and balances have been created to ensure that company bosses, who supposedly act as agents for shareholders, their principals, actually do so. Yet the cult of the all-powerful chief executive, armed with sackfuls of stock options, has too often pushed such checks aside.

It is time for another effort to realign the system to function more in shareholders' interests. Companies need stronger non-executive directors, paid enough to devote proper attention to the job; genuinely independent audit and remuneration committees; more powerful internal auditors; and a separation of the jobs of chairman and chief executive. If corporate America cannot deliver better governance, as well as better audit, it will have only itself to blame when the public backlash proves both fierce and unpleasant.

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America, nuclear weapons and proliferation

Ambushed

Feb 7th 2002
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How George Bush can be radical, but sometimes wrong

AP

THOSE who underestimate how the terrorist attacks of September 11th have sharpened America's sense of the threats it now faces do so at their own risk. While the presidential rhetoric is harsher, and the defence budget is sharply up, the message is not new. George Bush came to office bent on bolstering America's security against 21st-century threats.

The results have been revolutionary. A new strategic relationship is in the making with a friendlier Russia. Deep cuts in nuclear weapons are planned, along with exploration of limited missile defences against threats from “rogue states” with increasingly far-flying rockets. And there is a toughening towards regimes—like North Korea, Iran and Iraq which Mr Bush singled out last week—that break treaty promises by seeking nuclear, chemical or biological weapons.

All these targets are well chosen. Neither America nor Russia needs the piles of nuclear weaponry amassed when they were sworn enemies. Even sceptical Europeans and hostile Russians have come to accept, grudgingly, that clinging to the cold-war-era Anti-Ballistic Missile (ABM) treaty makes no sense if it prevents America, or Russia, from defending against new threats in the future. And turning a blind eye to treaty-breaking—Mr Bush mentioned the three worst offenders, but there are others—ultimately puts everyone's security at risk.

Yet the success of Mr Bush's arms-control revolution is still far from assured. The danger comes not so much from critics—they may blench at his unvarnished language, but few governments can fail to recognise the dangers he points to in an era of terrorism without constraint—as from the contradictory way he is going about things.

Do as you would be done by

He rightly aims to reduce the role of nuclear weapons in America's defences. Vladimir Putin is keen to do the same for Russia. Among the realistic threats (including a growing Chinese arsenal) that can be deterred by Mr Bush's proposed tally of 1,700-2,200 operational warheads, with plenty more in reserve, there are none that could not also be deterred by quite a lot fewer. But he is not only missing an opportunity to go for deeper cuts, he risks creating new dangers.

However the two sides codify future numbers—in legally binding form, as the Russians want, or in a looser agreement as some on his own team would prefer—Mr Bush wants America to have the option of building them up again. This is a worry, and not just for Russia. Both sides have long kept more warheads than they actually deploy. But this hedge against uncertainty will be a lot bigger than it need be, because the uncertainty will be greater too. After all, a deal that leaves America free to reverse weapons cuts at will leaves Russia the same freedom—with lots of room for misunderstanding. Such fuzzy nuclear maths will also make it harder for Mr Putin to come to a new understanding on missile defences before America withdraws from the ABM treaty in June. Failure to strike a new strategic bargain with Russia would leave Mr Bush free to build whatever weapons and missile defences he wants, but at the expense of strategic stability on which America's security, like everyone else's, depends.

Other “options” Mr Bush would like to reserve for America will make it harder to clamp down on

proliferation worldwide. He rejects the test-ban treaty that America had previously signed but not ratified, on the ground that countries possessing nuclear weapons must ensure they are safe and reliable—going bang only when intended. Indeed, the lower the overall numbers of weapons, the more confident they need to be in the designs they keep. Yet America has the safest, most reliable arsenal in the world, and other means than explosive testing of keeping it that way (as well as the right to withdraw from a test-ban deal, as it is doing from the ABM treaty, if threatening new circumstances arise). Rightly or wrongly, Mr Bush is suspected of keeping his testing options open to build new nuclear weapons, not tinker with old ones.

Either way, the promised test-ban helped win indefinite extension of the Nuclear Non-Proliferation Treaty, which Mr Bush wants to see reinforced. But if America can walk away from a bargain, so might others. At the very least, it makes it harder to press other governments to accept intrusive new checks for detecting clandestine bomb-making. Similarly, when Mr Bush recently lifted sanctions on India and Pakistan (both offenders against the anti-testing norm, though neither was a member of the NPT), the unfortunate message to other secret dabblers was that in the weapons-of-mass-destruction business nothing succeeds but success.

Mr Bush is right to take a radical look at how to deal with threats America faces. But it won't help if his policies for coping with a dangerous world are also at war with each other.

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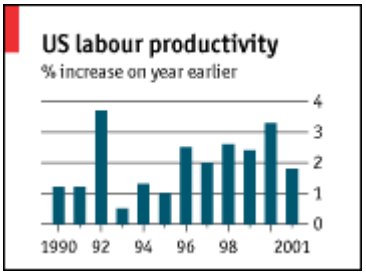
American productivity growth

Beware of false profits

Feb 7th 2002
From The Economist print edition

Faster productivity growth may not justify today's high share prices



THE American economy is being widely hailed for stepping along the road to recovery after one of its mildest recessions in the past half-century. Better still, figures this week suggest that the productivity miracle, a key element of the "new economy", is alive and well. Companies have been unusually quick during the recession to cut costs and boost their efficiency. This, it is argued, promises fatter profits in the upturn—and therefore justifies today's lofty share prices.

Unfortunately, even if the recession is over and even if productivity growth remains impressive, both of which are uncertain, the rise in profits over coming years is likely to disappoint investors. This week's news that productivity in America's business sector grew at an annual rate of 3.5% in the fourth quarter of 2001 cheered up an otherwise gloomy Wall Street. Companies may have inflated past profits, it was said, but at least future profits growth is on a firmer base. Yet quarterly productivity figures are volatile. Over the year to the fourth quarter, productivity rose by a more modest 1.6%. That is still good: in almost all previous post-1945 recessions, productivity actually fell. Last year's performance therefore appears to confirm that America has enjoyed an increase in trend productivity growth since the mid-1990s.

However, few economists argued that there had been no improvement at all. The question was: how big? As recently as a year ago, many new-economy fanatics claimed that sustainable annual productivity growth was as high as 3-4%. Data revisions and the recession have trimmed average productivity growth over the past six years to 2.4%. But some of that was the result of an unsustainable IT investment boom. Today's best guess is that trend productivity growth is a little over 2%. That is certainly a big improvement over the 1.4% average growth in the two decades to 1995—the equivalent of real incomes doubling every 35 years instead of every 50 years.

Yet red-blooded bulls are taking things too far in their belief that this faster productivity growth justifies high share valuations. They expect a sharp rebound in profits over the next year and beyond. The flaw in this is that the profits growth currently being discounted by the stockmarket assumes a far faster rate of growth in productivity than even the latest rosy figures support. Moreover, the link between productivity and profits is not straightforward; it depends critically on other factors, notably pricing power and margins (see article). The same information technology that has helped to lift productivity has also increased competition, by reducing barriers to entry in many industries and making it easier for consumers to compare prices. If increased competition keeps on shifting power from producers to consumers, this seems sure to squeeze profit margins, partly offsetting any gains from a faster growth in sales volume.

In a world of fierce competition and low inflation, the ability to push up prices is quite limited. The small rise in real GDP in the fourth quarter grabbed many headlines. But nominal GDP (ie, spending in money terms) actually fell, because prices also fell, for the first time in 50 years. Even as the economy picks up, nominal GDP growth is likely to remain slower than in other recent recoveries, cramping growth in profits. America's productivity gains deserve to be cheered, but investors who have bet their shirts on the stockmarket, or companies that are up to their neck in debts, would be unwise to look for help from a powerful rise in profits.

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Afghanistan

More soldiers wanted

Feb 7th 2002
From The Economist print edition

Hamid Karzai, Afghanistan's new leader, needs help

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AP

THERE will have been little point in smashing the Taliban in Afghanistan if the country is allowed to fall back into the faction-ridden chaos that gave that regime the opportunity to grab power in the first place. For the moment, that prospect still seems unlikely. The government of Hamid Karzai, Afghanistan's interim leader, seems more or less in control of the place. So far, clashes between rival warlords have been relatively restrained. Still, after the expenditure of so much effort to stop Afghanistan being used as a base for the export of violence and instability, it would be perverse not to heed Mr Karzai's appeals for more foreign troops to prevent the situation from worsening again. After all, it takes a lot for an Afghan to ask for the intervention of outsiders.

Late last year, as the Taliban crumpled, the first reaction of the Northern Alliance, the main opposition fighting force, was that no foreigners were needed. Most governments have been happy to take that insistence at face value, without considering too closely from whom it came: not from Mr Karzai, or the put-upon people of Afghanistan, but from warlords with an interest in being left alone to pursue their brutal ways. As a result, there are only some 3,000 or so foreign military helpers now in the country—compared with the 60,000 earmarked for much smaller Bosnia to preserve peace there, or the 40,000 for Kosovo—and only some 2,000 more are expected.

The International Security Assistance Force (ISAF) is doing an excellent job, but operates only in the capital, Kabul. The rest of the country has to fend for itself. Mr Karzai says that it is Afghanistan's provincial governors who want the ISAF's remit to be stretched. If the sort of arrangements now in place in Kabul were to be extended to the five or six next-largest cities, a force of perhaps 25,000 men would be needed.

Foreign troops cannot be expected to keep the peace everywhere. But in Afghanistan they can do a lot of good. The country is not at war: all parties have signed up to the new constitutional arrangements, despite some recent incidents of violence. A peacekeeping operation could be just that. Although the troops would need full authority to use force to protect themselves, the rout of the Taliban showed how completely western forces can dominate the military map.

Unlike in the Balkans, there are no strong separatist pressures. Afghans have a clearer sense of national identity than do, say, Yugoslavs (or for that matter Belgians). For most of the 20th century, Afghanistan was a peaceful, unified state. The government supports intervention, as Mr Karzai has made clear, and even the Northern Alliance is now on board.

There are also big security interests at stake. As the world has learned, a failed Afghanistan can do a great deal of damage not just to its immediate neighbourhood, but elsewhere too. That thought, plus the goodwill generated for his luckless country by the charming Mr Karzai, should be enough to make a bigger military assistance programme acceptable to the foreign taxpayers who will have to foot the bill.

Just a matter of weeks ago Britain, France and others were keen to send in a much bigger international force. Uncharacteristically, Tony Blair is now ducking that challenge, offering instead to help train a new Afghan army. Others might volunteer for the peacekeeping duties now needed if America lends

encouragement and support. Having so efficiently destroyed the Taliban, and installed its own, rather impressive, man, it is in America's interest to ensure that he stays there.

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Argentina and the IMF

Blame game

Feb 7th 2002
From The Economist print edition

Argentina needs help. It also needs to take responsibility

EPA

WHAT should the IMF do about Argentina? Despite the complexities, one thing is plain: whatever the Fund's political bosses end up deciding, the IMF as an institution can expect to be bitterly criticised. After all, Argentina is in this mess in the first place because of the IMF, or so numerous schools of critics agree. It helped too much last year, throwing good money after bad; to make things worse, it helped too little last year, failing to provide support when it was needed. It was too tough on Argentina, demanding fiscal austerity that the country's politics could not sustain; on top of that it was too soft, letting the government persist in failing policies. At least nobody at the Fund need lose sleep over this: good or bad, its next move will be chalked up as another great mistake.

The IMF is always in essentially the same fix. If it gives a big new loan to a country whose policies are too timid, in its view, to stabilise the economy, it is failing in its duty to member-governments and, ultimately, to the taxpayers around the world who underwrite its resources. If it withholds support, it stands accused of driving the economy into an even deeper slump, with the risk of political instability and social unrest. If it gets its way on policy, it gets the blame for the resulting economic pain, and is charged with trampling over democratic rights by coercing the government to ignore voters' demands and adopt policies they do not support.

Right or wrong, it's wrong

In Argentina, all these familiar problems are raised to the nth power. The government does not yet have a fully convincing stabilisation plan. In many respects, notably on floating the currency, its hand has been forced, and painful changes are in train. But there are holes. The government has yet to announce an inflation target. And it has postponed some elements of fiscal reform, especially at the provincial level. This goes to the heart of Argentina's problem. The government's new budget is austere on paper, to be sure, but is there a determination to see it through? That is not clear. To put it mildly, whatever money the IMF provides is going to be at risk.

On the other hand, the downside if no further assistance is offered looks very far down indeed. Conceivably it may even include an overthrow of the country's democracy. So far as ownership of the recovery plan goes, it is especially important in Argentina's case that citizens acknowledge changes in policy as the right thing in their own interests, rather than as something forced on them by outsiders, to be evaded or repudiated at the earliest opportunity. That kind of denial, together with the country's perpetual fiscal difficulties, goes some way to explain its sad economic history.

Still, there are one or two encouraging signs. For the moment, at least, most Argentines seem to believe that this is a mess largely of their own governments' making, not to be blamed on outsiders, and that the answer is mainly to be found at home. Also, although the new government of Eduardo Duhalde does not exactly fill one with confidence, it does seem to be learning (see article). It has changed its mind on the need for certain economic reforms, and may be open to persuasion on structural reform of the fiscal system as well. So far, reflecting the mood of voters, it has restrained itself in deploring in public the cruel demands of the IMF.

In its present dreadful plight, Argentina should not be abandoned. Given a three-quarters plausible plan for economic stabilisation, the IMF should lend its support. The gap between where the government is now and three-quarters plausible should not be impossible to bridge. Between here and reaching agreement on terms, though, what matters most is that the plan is seen to be Argentina's. Rather that than make a great show of dictating details which in the end may have little effect on the outcome, except to make it easier to abandon the deal in due course, with the blame laid at the door of outsiders. We urge the Fund, in planning its next public-relations disaster, to bear that in mind.

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Letters

Feb 7th 2002
From The Economist print edition

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Fundamental questions

SIR – I disagree with your survey of the universe (January 5th) in its support for fundamental physics and its modern theologians that try to lay claim to the creation of modern technology. Innovative technology is the preserve of engineers, who rarely rely on theory for their insights. Fundamental physicists would be hard-pressed to point to anything useful that was directly dependent on their theorising.

The discoveries of particle physicists or cosmologists are intellectually irrelevant to almost everyone—does it matter how old the universe is or if matter consists of two or 17 particles? If individuals wish to contemplate the universe, let them do so in their spare time at their own expense. Mayan priests (or scientists) expended all their efforts on star-gazing while their society foundered. It is far more important that we encourage our "best" brains to solve real problems and leave theology to the religious professionals.

Herbert Spencer
Aldergrove, Canada

SIR – You rightly argue that people who study fundamental questions are worth defending. But at what cost, what are the limits and who decides on priorities? In essence, society works because of the dynamic interaction of five core disciplines that are searching for answers to different questions. Science: what do we know? Technology: how do we use it? Economics: how much does it cost? Politics: who pays? And philosophy: what values are involved and what does it all mean? It needs wisdom to get the balance between the incomplete answers to all these questions reasonably right.

Bruce Lloyd
London

SIR – In your editorial, you say that the industrial revolution "has brought about the greatest improvement in the human condition since the invention of agriculture in the Neolithic era." In fact, the agricultural revolution resulted in a decrease in living standards for the vast majority of humanity.

Hunter-gatherers usually only had to work a few hours a day at subsistence needs. Most of their time was used for socialising, ritual, artwork or just relaxing. Forensic evidence also shows that they ate a lot better than peasants. After the introduction of agriculture the average height in Europe dropped by four inches. That peasants (and since Neolithic times the vast majority of humanity has been peasantry) had it worse than hunter-gatherers has been the accepted view of archaeologists for more than a generation.

Mike Ralls
Imari, Japan

Health of nations

SIR – We continue to rely on co-payments, tax write-offs, and shared-risk schemes to contain health-care costs but the real problem is the customers ("Treatment of choice", January 19th). Millions eschew simple measures like stopping smoking, daily exercise and regular check-ups. This is because they are in denial that couch-potatoism has consequences and they have abiding faith that modern medicine, paid

for by someone else, will undo their misdeeds. The best and only way to reduce health-care costs is prevention. Extra fees should be levied on those who opt for smoking and obesity as “lifestyle choices”. This would put the emphasis on health itself, where it belongs.

Pamela Logan
Altadena, California

Nuclear security

SIR – Security for radioactive materials is not just guns, it includes oversight by experienced physicists and nuclear engineers at centres of management (“Obey the rules”, December 22nd). Your suggestion that Maine might need patrols by the National Guard, at a closed nuclear-plant site, may cause readers to conclude that the facility is not amply guarded by private forces. In fact, it is. That said, the best security for spent nuclear-fuel is private-sector expertise, federal-level military equipment and support, and federal investment for research to address issues both of spent-fuel toxicity and volume.

The government routinely transports spent nuclear fuel of all pedigrees—except commercially generated—to federal-management centres. Stranded radioactive materials are particularly risky and costly at closed plants after experienced, professional personnel have left. Activists and advocates need not quarrel about a solution for spent fuel from a decommissioned plant like the one in Maine. When societies retire nuclear weapons and close nuclear-power plants, we need promptly to transport stranded radioactive materials, like those in Maine, to centres of management, not post local soldiers at a rusting gate.

Paula Craighead
Maine Nuclear Safety Adviser
Augusta, Maine

Examining Camp X-Ray

SIR – Lexington (January 26th) says that “the al-Qaeda detainees are not ordinary criminals.” Correction: they are not ordinary suspects. Blur the distinction between these two vital concepts and you will make a lot of reasonable people feel very uneasy, especially if they already doubt the court's credentials.

David Alexander
Zeist, Netherlands

SIR – I have just finished reading the most revolting article I have seen in *The Economist*. Lexington says that the cages used to detain al-Qaeda prisoners are humane. Let us put Lexington in a small cage.

Claudio De Diana
Munich

SIR – Lexington fails to recognise the significance of Camp X-Ray. This is not a quarrel over the treatment of a limited number of detainees. America is clearly asserting its right, as the only world superpower, of acting unilaterally. This is a debate over a principle.

Nikolaos Spyropoulos
Guildford, Surrey

Smug pontificating

SIR – You do yourself and your readers a disservice by pouring so much scorn on Ken Loach and his European audiences (“Ken who?”, January 19th). You may dislike his work or disagree with his politics, and even resent his success abroad (although why would be a mystery), but readers are entitled to proper arguments rather than tired clichés, cheap irony and sophomoric rhetorical tricks. More disturbing still is the deliberate nurturing of embittered misconceptions. British literature, philosophy and film have always enjoyed great influence in France. Your innuendo that “anything of that sort coming out of Britain” would be held in contempt by the French is as ignorant as it is absurd.

You rightly point out that Mr Loach's work (whose tone, incidentally, is no more “predictable” than, say,

The Economist's), is also popular in Germany and the Netherlands (a country that surely cannot be accused of Anglophobia). Why do you insist that Mr Loach's social critique is what explains his “French reputation”? Perhaps what he has to say has wider appeal than you imagine, and is not confined to “indulging in an ancient French pastime”. In fact, your article might lead some readers to suspect that you are indulging in an ancient pastime of *The Economist*, namely, smug pontificating along with a dollop of French-bashing.

François Grin
Geneva

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Balkans war crimes

One brought to justice, many at large

Feb 7th 2002
From The Economist print edition

The trial of Slobodan Milosevic, which opens on February 12th, is one of many ways in which the Balkans are trying to face their past

Get article background

EPA

JUST below the old Muslim cemetery in Tuzla, an undulating hillside dotted with slender, round-topped gravestones, stands a new building whose stark, prefabricated style is a trademark of Bosnia's “internationals”—well-paid expatriates who abound in the Balkans, doling out economic assistance and political advice. Visitors to this place are greeted by courteous, multilingual young Bosnians, well practised in dealing with foreign benefactors.

But this shiny white building does not contain medicine or educational aids or even ballot boxes. About half its surface area—260 square metres—consists of a single refrigerated space, with shelves going up to the ceiling. Every shelf is packed tight with metal trays, and each tray holds two or three synthetic canvas bags containing the bones of a human being. In all, the room contains about 3,600 skeletons—only half of them complete—of men and boys from Srebrenica, the formerly Muslim “safe area” in eastern Bosnia, whose male population was virtually wiped out by Serb soldiers in July 1995.

Thanks to some recent advances in DNA technology, these pathetic bags may not be there much longer. The International Commission on Missing Persons, based in Sarajevo, is taking tens of thousands of blood samples from people from Bosnia, Croatia, Kosovo and Serbia proper who lost relatives in the war, and is also analysing genetic material from skeletons recovered in all the former war zones. Computers will then be used to match blood with bones, and thousands of families will be able to identify loved ones and bury them decently.

Tuzla's house of the dead forms a grisly counterpoint to the forthcoming trial of Slobodan Milosevic, the disgraced Serb leader. Mr Milosevic is by far the most important of the 80 people indicted so far by the international tribunal at The Hague, established by the United Nations to deal specifically with such crimes in the former Yugoslavia. The charge-sheet against the man who dominated Serb politics for 13 years—until he was toppled in October 2000—includes violations of the Geneva conventions, which are supposed to protect non-combatants and prisoners-of-war; violations of other laws and customs of war, such as those which protect schools and churches; crimes against humanity; and, above all, genocide, the attempt to wipe out a race, religious group or ethnic community in whole or in part.

The trial of Mr Milosevic will be a landmark in legal history—the first time that a head of state has been hauled before an international court to answer for such exceptionally grave crimes. Depending on your viewpoint, that will either be a token of the civilised world's determination to make a start, at least, on outlawing bullies and sadists in high places, or a proof of the world's double standards. Plenty of other leaders, in good standing at the UN General Assembly, have also been responsible for mass deportation, extra-judicial killing and other forms of state terror.

Plenty of other leaders, in good standing at the UN General Assembly, have been responsible for state terror

The prosecutors' burden

Mr Milosevic's prosecutors have set themselves an ambitious task. They must prove that the persecution of non-Serbs in Croatia, Bosnia and Kosovo was part of a single criminal conspiracy to create an ethnically pure “Greater Serbia”. The judges, reversing an earlier decision, agreed on February 1st that charges relating to all three wars would be heard together. The hearing may yet provide sensational evidence of the way Serbia's media, security forces, judiciary and political class were co-opted for the Greater Serbian cause.

Mr Milosevic has refused to recognise the court or to appoint a defence team. But he is informally accepting the advice of some controversial figures in the field of international law, including Jacques Vergès, the maverick French lawyer whose clients have included Nazis and Latin American terrorists. He has threatened to call as witnesses the western leaders, including ex-President Bill Clinton and Britain's Tony Blair, who ordered the 78-day bombing of Yugoslavia in 1999 which at last forced the Serbs' army out of Kosovo.

Mr Milosevic will also challenge the prosecutors' claim that the sufferings of non-Serbs in three wars were the result of a single premeditated plan. While Bosnia and Croatia were independent states (in whose internal conflicts Mr Milosevic, as Serbian leader, claimed not to be involved), Kosovo was, legally speaking, part of Serbia; and Serb rule had been challenged by an armed uprising which western governments had at one time described as a “terrorist” movement. So the stage is set for some dramatic courtroom exchanges, which could establish important precedents in international law.

Comforting, but not enough

Supporters of the Hague process say it will serve a whole series of benign and closely interlocking purposes. First and foremost, they say, it will satisfy the desire for “natural justice” among people who feel that exceptional acts of cruelty should not go unpunished. It will also tell future warlords and their political bosses that they cannot expect the slaughter of civilians in war to go unnoticed, or attempt to excuse it away. And, by singling out the people who are most guilty, some Balkans-watchers think the trials in The Hague will help to remove the shadow of “collective responsibility” from communities in whose name terrible deeds have been done.

Still, not all the people who are most immediately affected by the recent tragedies of the Balkans feel any great enthusiasm for the tribunal's work so far. Prominent among the current residents of Tuzla is a feisty lobby of Muslim mothers and widows from Srebrenica who have a collection of 6,000 pillow cases, each embroidered with the name of a missing loved one. They are sceptical about the feasibility of matching names with bodies and, as for the trial in The Hague, they consider this the minimum the outside world can do to assuage their desire for justice.

AP

The charnel-house of Tuzla

“We have waited so long, to see just a few people put on trial,” complains Nura Begovic. “They say they will only put the big fish on trial, but why should the small fish get away scot-free?” Some who played an active part in the massacre, the women complain, are now serving in the local police. Mrs Begovic would like to see the Hague tribunal equipped with its own forces, so that it can go and arrest people like the two main architects of the Bosnian Serbs' ethnic-cleansing campaign, Radovan Karadzic and his military commander, Ratko Mladic. Western special forces are known to have tried, but the two men are well guarded.

The women of Srebrenica are also furious that UN war-crimes investigators have interrogated Naser Oric, the young Bosnian Muslim commander who was in charge of Srebrenica's defence forces. To local Serbs, Mr Oric's name is associated with raids launched from Srebrenica in which scores of their ethnic kin were killed. To Bosnian Muslims, he is a hero. In this part of the world, people are usually prepared to make excuses for the atrocities committed by their own side.

Although well over half the people in the Hague tribunal's sights are Serbs, the tribunal has also indicted and convicted several Bosnian Croats and Muslims. The court is also understood to have issued secret indictments against at least four prominent Kosovo Albanians for the killing of Serb civilians during and after the 1999 war, though releasing their names is considered too explosive.

Sefket Hafizovic, the Muslim mayor of Srebrenica, argues that any atrocities committed by his side should be judged in the context of the war as a whole: a war, as he sees it, of self-defence. In fact, the significance of the “context” in which atrocities were committed is one of many grey areas in international law as it relates to crime on the battlefield. The Geneva conventions, for example, make no distinction between offensive and defensive operations in their provisions which outlaw the killing or mistreatment of non-combatants.

In practice, the court of public opinion does make a distinction. When, a few weeks after the Srebrenica massacre, Croatian and Bosnian forces made storming advances elsewhere—displacing up to 250,000 Serbs and killing hundreds of civilians—the reaction of the outside world ranged from indifference to hearty approval. This reflected a perception that the Serb side had been mainly responsible for the war's earlier horrors, up to and including Srebrenica, and was now getting its just deserts. But that does nothing to comfort the families of the 6,000 or so Serbs—mostly non-combatants—who went missing at various times during the war.

Many of the more profound moral issues raised by the Balkan wars cannot yet be answered

Many of the more profound moral issues raised by the Balkan wars—especially the sins of omission by politicians, local or international, who might have intervened to avert tragedy but did not do so—cannot yet be answered. The documents which could help resolve those questions remain well sealed in government archives. But by cross-examining hundreds of witnesses, ranging from generals and politicians to frightened widows and rape victims, the court has already done a huge service to historians and moral philosophers of the future. The trial of Mr Milosevic, which may last as long as two years, will no doubt be of even greater benefit, bringing to the surface all manner of shady deals, conspiracies and calculations that were never intended to see the light of day.

The court has already issued one document of devastating moral force in the form of a 100-page judgment finding General Radislav Krstic, a Serb commander in Srebrenica, guilty of genocide. While noting that the events in Srebrenica “defy description in their horror”, the judgment says it must be left to historians and social psychologists “to plumb the depths of this episode and to probe for deep-seated causes”. The judges confirm that the Bosnian army deliberately violated the enclave's demilitarised status. But they also insist that nothing done by the Bosnian Muslim side excuses the massacre.

The wider consequences

Although he is frustrated that so many suspects remain at large, the chief international envoy to Bosnia, Austria's Wolfgang Petritsch, believes the tribunal has had a helpful effect on the political atmosphere in the region. Many Bosnian Serbs, for example, have realised that their community will not regain respectability unless it parts company with its wartime leaders.

Many Bosnian Muslims have maintained that the tribunal's work ought to have even more tangible political consequences. They insist that since the Hague tribunal has affirmed the “genocidal” character of the project to create a Serb-only state in Bosnia, it is no longer acceptable, either legally or morally, for Bosnia to be partitioned as it is under the Dayton peace deal, with half its territory allocated to a Serb republic. Mr Petritsch does not go quite that far. But in his view, the “genocide” verdict at least puts massive pressure on the authorities in Bosnia's Serb sector to renounce for ever the idea of an ethnically pure state, and to welcome back Croat and Muslim families displaced from that region during the war. So in practice, the Austrian diplomat believes, the “Serb republic” will become less and less different in character from Bosnia's other half, a federation of Croats and Muslims.

In Serbia, those who feared that the extradition of Mr Milosevic would create a terrible backlash have

been proved wrong. Although Serbian citizens have little appetite for investigations of the misdeeds committed in their name, most have little sympathy for their erstwhile ruler—or the four other senior Serbian politicians who were indicted with him in May 1999. If there is one war-crimes suspect who is still considered a hero by many Serbs, both in Bosnia and Serbia itself, it is General Mladic, whom others regard as one of the darkest figures in the Balkan tragedy. A botched operation to seize him might only bolster his legendary status.

Last year, the Belgrade media carried a series of shocking revelations about the existence of mass graves in Serbia containing the bodies of dozens of ethnic-Albanian civilians from Kosovo, apparently killed during the 1999 conflict and then spirited away from the war zone. But the release of these horror stories—clearly timed to reconcile public opinion to the extradition of Mr Milosevic—has not, as it turns out, led to a new climate of openness or self-examination by Serbia's secretive security establishment. Since last summer's disclosures, no further information on graves inside Serbia has emerged.

Zoran Djindjic, the reformist Serbian prime minister, has presented the case for co-operating with The Hague in pragmatic rather than ethical terms. Since the western world, including the European Union, had made the handover of suspects to The Hague a strict precondition for economic aid and normal relations, Serbia had little choice but to co-operate. The political class is still deeply divided on the subject. Vojislav Kostunica, the law professor who is president of the rump Yugoslav federation of Serbia and Montenegro, has never hidden his distaste for the Hague tribunal. It was on the personal authority of his rival, Mr Djindjic, that Mr Milosevic was extradited. Some veterans of the anti-Milosevic dissident movement, on the other hand, regard the Hague tribunal as a godsend, and one which may deter leaders from pursuing ethnic purity in future.

Looking the other way

In the glitzy prosperity (by Balkan standards, at least) of Zagreb, the Croatian capital, the war already seems a much more distant memory than it does in Belgrade. Croatia's co-operation with the war-crimes tribunal has been smoother since the death in 1999 of President Franjo Tudjman and the electoral defeat of his nationalist party. War-veterans' groups have protested loudly—but in smallish numbers—about the prosecution of Croatian “national heroes” who deserve to be given medals, not jail terms. Liberal Croats, meanwhile, have been hoping the Hague court will finally bring to light the murky conspiracy between Mr Tudjman and Mr Milosevic to carve up most of Bosnia between them. But even they were shocked by the 45-year sentence handed down in The Hague to Tihomir Blaskic, a general who fought the Croats' corner in central Bosnia but was not regarded as the main instigator of dirty Serb-Croat deals.

Vladan Batic, the Serbian justice minister, speaks for many moderates in Belgrade when he says people must accept the principle that evil deeds cannot remain unpunished and that new states cannot be built “on foundations soaked with blood”. But that principle, he insists, ought to be applied even-handedly—and in particular to the military and political bosses of the ethnic Albanian community in Kosovo, whom Serbs hold responsible for killing hundreds of Serb civilians and displacing tens of thousands. The Belgrade government has sent 30,000 pages of evidence against Kosovars to The Hague.

Just how difficult it would be, in practice, to bring war-crimes suspects in Kosovo to account was demonstrated on the streets of Pristina, the provincial capital, this week. Thousands of people demonstrated against the arrest of three Kosovars, all veterans of the notionally defunct Kosovo Liberation Army or its political offshoots. The three were charged with killing fellow-Albanians, not Serbs, and were hauled before one of the local UN-sponsored courts whose remit includes relatively small-scale war crimes. But diplomats in Pristina say the furious reaction on the streets is only a foretaste of the anger that could ensue if a senior politician was packed off to The Hague, charged with killing Serbs.

While the judges and prosecutors in The Hague have no mandate to consider anything but the letter of international law, the western governments which support the court—both financially and politically—have often, in reality, tempered their ardour for justice in the Balkans with considerations of political or diplomatic expedience. The settlement patched together last autumn between Macedonia's Slav-dominated government and the ethnic-Albanian rebels included an implicit amnesty for most armed actions, although the Hague tribunal has investigated allegations of atrocities by both sides. Kosovo's international overlords have in practice turned a blind eye to atrocities when doing so seemed a necessary price to pay for stability in the volatile province.

In Bosnia, too, many agree that war-crimes trials alone will not achieve reconciliation. Jakob Finci, a respected leader of Sarajevo's small but vigorous Jewish community, feels that an even more important

part will be played by a soon-to-be-established truth and reconciliation commission, which hopes to take thousands of hours of evidence from victims and penitent perpetrators of wartime misdeeds.

Zlatko Lagumdzia, Bosnia's chief minister and the leader of its most ethnically-mixed party, believes that, as well as trying the guilty, the surest way to consolidate peace lies in binding the country as closely as possible into pan-European institutions of every kind. “We must bury Mr Milosevic in 80,000 pages of European law,” he argues. Fortunately, or unfortunately, there is no provision in the Hague tribunal's statutes for such cruel and unusual punishment.

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The Mormons

The church of the West

Feb 7th 2002 | SALT LAKE CITY
From The Economist print edition

Within four decades, one in 20 Americans may be a Mormon and there may be 50m or more worldwide. How will outsiders react to the next world religion?

IN 1847, on the slopes where 1m visitors will descend to watch the 2002 Winter Olympics, 148 pioneers arrived by wagon to build the city of God. They created something extraordinary. Tolstoy called Mormonism “the American religion”. Harold Bloom, a professor at Yale, argues that “the Mormons, like the Jews before them, are a religion that became a people.”

Corbis

In Utah, the Church of the Latter-Day Saints (as Mormons call themselves) is by far the most important public institution, with all-encompassing claims on the loyalty of its members far outstripping those of the state or nation, even though Mormons are among the most patriotic of Americans. Mormons account for 70% of Utah's 2.2m inhabitants. Yet all of the state's representatives in Congress, all of its Supreme Court, 90% of its legislature and 80% of its state and federal judges belong to the church. Not surprisingly, critics fear the Mormons are creating a theocracy.

Outside Utah, the number of Mormons has trebled in America over the past 30 years. The total for the whole country is now more than 5m (making them almost as numerous as the Jews). Outside America, where membership has increased even faster, there are now as many Mormons as in the United States, bringing the total to above 11m. Back in 1980, Rodney Stark, a professor at the University of Washington, predicted, to much derision, that there would be 10m Mormons in 2000. He now estimates 50m by 2040. If current growth rates continue, the Latter-Day Saints will be numbered in the hundreds of millions by 2080 and Mormonism will be, you might say, the first new world religion since Islam.

The hordes of sports fans gathering in Salt Lake City this week may be forgiven for ignoring this ferment. In the interest of good neighbourliness, the church has taken care not to preen itself. Yet the visitors will influence the church's future indirectly. “The Olympics”, says Ted Wilson, a former mayor of the city, “means the refuge is over.” In other words, Mormon Utah can no longer command the privacy it used to enjoy.

To their critics, the Mormons' phenomenal growth is a danger. They argue that the church's political power threatens the wall between church and state; that Mormons' cultural conservatism limits the rights of non-Mormons (look at the state's anti-alcohol and anti-gambling laws); and that the inward-looking quality of the church (most Mormons mix with others of their faith) is divisive and menacing.

These charges are exaggerated. The alcohol laws are annoying rather than oppressive. The Mormons'

undoubted conformity has not stopped the non-Mormon population of Salt Lake City becoming as diverse and lively as that of any other big city. But the charges raise a more interesting issue: the church's contradictory attitude towards its recent achievements. It is this that causes many of the difficulties the church now faces.

If you go to the Mormons' visitor centre at the heart of Salt Lake City, the smiling hosts will describe a mainstream American Christian church—faster-growing and more conservative than most, but otherwise nothing out of the ordinary. Its doctrines seem unexceptional. It lays great stress on the nuclear family. Its views on abortion, same-sex marriage and lifestyle are culturally conservative; Mormons do not drink alcohol, coffee or tea, and do not smoke or gamble. They also have an uninhibited attitude to capitalism, running plenty of for-profit firms.

Despite accusations of a “quasi-theocracy”, the church is in some ways ostentatiously apolitical. Its leaders, unlike those of many other churches, refuse to endorse candidates for office. It takes public positions only on moral matters, such as abortion. It insists on obeying the laws of even the dictatorial countries where its missionaries roam. One senior Mormon, Dallin Oaks, quotes scriptural authority for his view that “Latter-Day Saints obey the law, participate in the affairs of government at all levels and serve in the armed forces of their respective nations.” In short, Mormons appear to be a mainstream evangelical church, upholding private property, traditional family values and the separation of church and state.

Yet, when they were founded in the early 19th century, the Mormons mounted radical challenges to each of these things. Early Mormons practised polygamy, which conflicts with the traditional nuclear family. Between 20,000 and 60,000 people still practise polygamy clandestinely, but the church long ago abandoned it and excommunicates its practitioners.

In the early years, the church was almost communist in its attitude to private property. It required Mormons to hand over their goods to the church, which then handed them back but gave the former owners only “stewardship” over them. This meant that the church's leaders could make discretionary demands on the faithful for the greater good. Like polygamy, this system was abandoned long ago, as the church's embrace of corporate capitalism shows. Yet vestiges remain.

The church is extraordinarily demanding of members' time and money. Mormons are supposed to “tithe”—that is, give 10% of their income to the church. Nearly two-thirds do so, accounting for most of the church's estimated income of $6 billion a year. They also voluntarily give anything up to 40 hours a week to church-run activities, an extraordinary commitment of time that helps to sustain one of the world's most impressive welfare services. At the local level, argues Dean May, a historian at the University of Utah, Mormons are far more “communal” in their attitudes than is normal in individualistic America.

Cannon to the right of him

More controversially, early Mormon doctrine contained such startling departures from Christian orthodoxy that some conservative churches even now question whether Mormons are Christians at all. The orthodox view of the afterlife is that good Christians spend eternity in the presence of God. Mormons believe in something different: “eternal progression” towards God. Their notion is that the soul exists throughout all time (before this earthly life as well as after it), with Latter-Day Saints advancing slowly to spiritual completion. The idea has something in common with eastern faiths; the lama in Rudyard Kipling's “Kim”, with a reservation or two, would have nodded gently.

The logical conclusion of eternal progression is to muddy the difference—fundamental to other Christians—between God and man. The Mormons' founder, Joseph Smith, went so far as to say that “God himself was once as we are now, and is an exalted man.” And if men have the capacity to be like God, that implies there could be a “plurality of Gods” (the Mormon phrase). To critics, this is mere polytheism.

Some Mormons want to play down parts of this doctrine, but eternal progression influences several beliefs that others find curious. As members of a relatively new church, for example, Mormons face the problem of how to treat people born before their prophet was, in 1805. They solve it by a doctrine of posthumous baptism: America's Founding Fathers and Shakespeare are among the millions accepted as Mormons.

More important, the notion influences the Mormon view of government. In the early years, church

leaders were theocrats, not democrats, and saw no distinction between church and state. Joseph Smith was running for president when he was murdered by a mob in Illinois. Brigham Young was governor of the Utah territory and president of the church.

Utah is no theocracy now but, unlike most churches, Mormonism retains a distinctive view of the state which derives from theology. Chris Cannon, a Mormon congressman, explains it as follows. Earthly life, Mormons think, is the time when the soul is tested. For the test to mean anything, people have to be free agents; if they are not, the test will be meaningless. So, says Mr Cannon, “for Mormons, the question of what the government does is one of the most important we face.” The government's role, he concludes, must be minimal, to leave people free to make their choices. As a good Mormon, who believes in proselytising, Mr Cannon is not just talking in the abstract: he wants this conception of the state to influence governmental reforms in places like Afghanistan, Pakistan and Iran.

Mr Cannon is also a conservative Republican, which may explain his “leave-us-alone” view of the state. Mormon Democrats (there are a few of them) reply that very poor people, and drug addicts, are hardly free agents; so these Mormons want a more active government.

In each of these matters, the church has made huge adjustments in the past decade or two. But in all of them, except polygamy, the basic ideas that set Mormons apart are still there. That reflects both the church's flexibility and its strength. But, as its membership continues to rise, the adjustment raises two big questions for the church and for the outsiders who are increasingly affected by what it does. How much further can it move away from what were once its fundamental beliefs before it loses its identity? And, if it cannot move away, or compromise, how will this affect its relations with non-Mormons?

The trouble with being so big

The central challenge for the church is to keep alive its sense of being, as Mormons put it, “a peculiar people”—the chosen ones, rather like the Jews. For Mormons in Utah, this sense of being apart is bred in the bone—by the history of their great trek into the wilderness and, especially, by their history of persecution. It is hard for Mormons to forget that their founder was killed by a lynch mob and that the federal government once sent an army to exterminate them.

How do you maintain this sense of peculiarity when Utah's Mormons represent only 14% of the church's worldwide membership? The church's leaders try to answer that question by maintaining that there is a universal Mormon identity (something that all religions have had difficulty achieving, even when they have pursued it). How far the leadership can continue doing this as congregations abroad get ever huger is open to doubt.

The relationship between Mormons and other believers is no less tricky. For the moment, the fact that the Mormon church is such a hierarchical organisation (with power exercised by small groups of men who meet in secret) works in its favour. The leadership has been assiduous in trying to open up the church, admonishing Mormons against the dangers of clannishness. The real trouble comes from the bottom of the church, not the top: the conservatism of most church members and the inward-looking quality of Mormonism almost inevitably separate Mormons from others.

Last year the *Salt Lake Tribune*, the city's main non-Mormon daily, commissioned an opinion poll which found that two-thirds of those living in Utah recognised a cultural fault between Mormons and non-Mormons. Of course, the sheer size of the church in Utah contributes to the conflict: it is the 800-pound gorilla which doesn't have to do anything to seem threatening. But, as Mormonism spreads, that problem may spread too.

Throughout its history, outsiders have criticised the Mormon church as isolated, marginal and rigid. It has begun to slough off those qualities. But it is still unclear whether it can rid itself of the other feeling it elicits, however unfairly: hostility towards what is different.

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George Bush's budget

Unfurl the fuzzy maths

Feb 7th 2002 | WASHINGTON, DC
From The Economist print edition

Fortunately, the president's bold but fiscally-challenged budget won't become law. Unfortunately, something worse might

AP

But his surplus is shrinking

GEORGE BUSH'S budget is not for the faint-hearted. It is big. His $2.13 trillion spending plans for 2003 include a 14% increase in the defence budget, the biggest rise since Ronald Reagan, as well as a doubling of spending on homeland security. It is bold. By keeping overall government spending outside defence and homeland security to a 2% rise next year (compared with a recent annual average of more than 7%), Mr Bush is proposing a dramatic shift in America's spending priorities.

And it is brazen. Far from trimming his tax cuts to help pay for more guns, Mr Bush reinforces, nay increases, his proposed tax cuts by almost $600 billion over the next decade. He wants to make permanent last year's tax cuts (which officially run out in 2010, due to a budgeting quirk). And he has added new ones—from a tax credit for health-care premiums to a tax deduction for charitable contributions. Even the Gipper could not go that far: about 30% of Mr Reagan's 1981 tax cut was clawed back in tax increases in 1982-84.

The result is a dramatic turnaround in America's fiscal outlook. Far from using the Social Security surplus to pay down debt or restructure America's pension system—a goal both parties claimed to be overriding only nine months ago—Mr Bush's budget uses the surplus to pay for defence spending and, particularly, tax cuts. According to the Bush plan, the overall budget (ie, including Social Security) will be in deficit until 2005. Over the next decade there will be a small surplus of $665 billion—compared with the forecast surplus of $5.6 trillion that his administation inherited. And once the inevitable fuzzy maths and a spendthrift Congress are taken into account, that disappears too.

Mr Bush has wrapped his budget in the flag (literally: the cover of the budget book is swathed in stars and stripes). He has described it as “a plan to fight a war we did not seek, but a war we are determined to win.” He is unlikely to face much opposition to the proposed money for homeland security or the Pentagon.

The $38 billion for homeland security is to be divided between bioterrorism defence, firemen, police, airport and border security, and better intelligence. The Pentagon's increase of $38 billion, with the spectre of a further $10 billion if needed to fight a war, is for the struggle against terrorism and to “transform American armed forces”. It includes a popular 4.1% pay rise for servicemen as well as cash for the kind of equipment used in Afghanistan: unmanned aerial vehicles, precision weapons and new

gizmos for ground troops. More controversially, it also includes plenty of money for a missile-defence shield. Some military reformers are disappointed by the decision to hang on to three new kinds of tactical fighter aircraft and a heavy artillery system. Nonetheless, there is scant sign of any opposition in Congress.

America's lawmakers, inevitably, are unhappy about where Mr Bush wants to trim spending, not where he wants to boost it. Unlike Mr Reagan's efforts at spending cuts, the Bush budget does not go in for high-profile cost-cutting (by, say, eliminating a department here or there). Instead it makes much of improving efficiency (government bureaucracies are graded on their effectiveness with colour-coded dots), tries to squeeze spending on non-priorities across the board, and explicitly attacks the congressional penchant for stuffing pet-pork projects into spending bills. The budget even includes specific examples, such as the $80,000 wind-sledge that Congress earmarked for a sheriff in Wisconsin.

Mr Bush, rightly, wants to get rid of this bacon. Unfortunately, last year his administration failed dismally to do so. It is hard to see what has changed since then. Congressmen have already labelled some of Mr Bush's specific cuts as “dead on arrival”. More important, the future cuts in non-defence discretionary spending implied by the Bush budget projections (but not spelt out) are too tight to be credible. Implicitly, he assumes that spending will fall in real terms even as the population grows. The lesson of the past few years is that such cuts simply will not happen.

That is why prudence suggests holding back on the tax cut. But Mr Bush has done nothing of the sort. Not only has he extended tax cuts, but he has tried to hide the cost of doing so with accounting techniques that would make Enron proud. The most egregious is the Bush assumption about the Alternative Minimum Tax (AMT), a tax designed to ensure richer people do not get away with paying too little tax by claiming numerous deductions.

The structure of the AMT implies that millions of ordinary Americans should end up paying this tax over the next decade, an outcome no one believes politically feasible. The 2001 Bush tax bill “fixed” this problem by raising the threshold at which people pay AMT until the end of 2004. This budget assumes it is not fixed thereafter—something that saves Mr Bush some $300 billion over the next decade. But that would also mean some 39m people paying AMT in 2012, which Congress and Mr Bush would never allow. Once you adjust his budget for this sort of chicanery, the true cost of the tax cuts in his budget is around $1 trillion over ten years.

Fortunately, this budget will not become law. It is merely the opening salvo in the annual fiscal duel between the White House and Congress. Already one component—Mr Bush's planned economic stimulus—is history. Senate Democrats this week in effect killed further discussion of a stimulus bill. The problem is that Mr Bush's budget sets the tone of the debate. By devoting the Social Security surplus to guns and tax cuts, the risk is that he has merely opened the floodgates.

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Water politics

Hold your breath, suckers

Feb 7th 2002 | SAN FRANCISCO
From The Economist print edition

A fish that has divided the west may help define Gale Norton's greenery

AP

Dry wit

ACROSS the American west, few laws stir more passion than the Endangered Species Act. Farmers, industrialists and conservatives fume that the ESA has become a way for environmentalists to enlist such previously obscure creatures as the spotted owl and the snail darter in anti-business campaigns. Last year the greens seemed to have surpassed themselves by choosing a casus belli that is small, ugly and risibly named: the sucker fish.

The water which succours both the sucker fish and hundreds of Californian farmers starts in a series of mountain lakes and marshes, mostly in Oregon. These drain into the Klamath river, which flows southward into California and then westward to the Pacific. All told, there are more than 700 legal claims to the Klamath Basin Irrigation Project; broadly, they are of four main kinds:

•**Wildlife.** Two species of sucker fish live in the Upper Klamath Lake. Another officially endangered species, the coho salmon, spawns in the Klamath river. Migrating birds stop in its marshes on their way from Alaska to Central America.

•**Indians.** Today the three mountain tribes that fished for suckers limit their catch to one ceremonial fish a year, but they continue to treasure it as part of their culture. The Yurok Indians who live downriver still fish for salmon.

•**Farmers.** In 1907 the Bureau of Reclamation started to pump water from the Klamath basin into an irrigation system that nourishes 200,000 surrounding acres of rich but otherwise dry soil. Most of today's farmers are the descendants of ex-soldiers who were invited to take part in lotteries for parcels of land.

•**Commercial salmon fishers.** These operate near the mouth of the Klamath river. They are often at loggerheads with the greens or the farmers.

Even in wet years, the needs of these four groups are not equally satisfied. In the past, the fish and the Indians have given way. Years of damming, irrigation, overfishing and agricultural run-off have drastically reduced the number of salmon in the Klamath river. The lakes of the basin are clogged with algae, thanks to pollution seeping in from neighbouring farms; the lakes have been depleted as farmers draw out water to support crops such as mint, alfalfa and potatoes.

Last winter a third of the usual amount of snow fell in the mountains around the basin. In the spring, biologists at the Fish and Wildlife Service judged that the water level in the Upper Klamath Lake was in

danger of sinking so low that pollutants might kill off the sucker fish. So on April 7th they turned off the irrigation system.

For the farmers, this was devastating. Their crops shrivelled; new ones never got sown. They reckon they have lost $200m. Business in Klamath Falls, a city of 40,000, and three smaller towns has suffered. Throughout last summer, rallies at the gates of the irrigation project in Klamath Falls drew supporters from across the west. Four times, farmers broke in to set up syphons; but they called off their protests on September 12th after the terrorist attacks on New York and Washington. Since then both sides have waited for an inquiry into the Klamath basin by the National Academy of Science, ordered by Gale Norton, the secretary of the interior.

The academy's findings have now been leaked to the press. It concludes that there is no clear scientific link between the water levels in the lakes and the numbers of sucker fish in them. The science of the sucker fish is still not well understood, and the coho salmon downstream are unquestionably under pressure. But the farmers should have got their water.

Conservatives claim that scientists working for the Fish and Wildlife Service are biased against business. The Klamath report comes after two researchers in Washington state were found to have made up claims that they had found wild lynx hair in local forests (if lynx had been there, limits would have been imposed on activities such as driving snowmobiles).

The Klamath report also seems to confirm Ms Norton's approach. Because she once worked for a group that fought against the ESA, greens hated her appointment. But so far she has not sought to gut the act. Instead, she seems to be insisting on scrutinising the science it relies on. That implies gradual change on a case-by-case basis. But it does little to settle the ancient disputes between farmers and greens.

Two approaches—one scientific, the other economic—offer some hope. The first argues that the sucker's problems are to do with water quality, not quantity. Alex Horne, an ecological engineer, points out that five big declines in the sucker fish since 1970 have all taken place at times when the lake was at its average depth, or even deeper. He is experimenting with pumping oxygen into the water. The economic way out is the use of market discipline. Last year, some farmers, with about 10% of the total land, sold it to a conservation trust that intends to leave the land undeveloped. That may seem a decent compromise; the sellers got more than the market price for their land. But other farmers regard them as traitors.

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Homeland security

The Trojan box

Feb 7th 2002
From The Economist print edition

The biggest threat may now come from containers, not aircraft

ACCORDING to one senior figure in the American defence industry, the Bush administration's main concern over homeland security has switched from airlines and airports to seaports and containers. Last year around 18m of the ubiquitous 40-foot (12-metre) metal boxes entered America's ports in shiploads of up to 8,000 at a time. A small number are already used by criminals to carry drugs and other contraband. Why not terrorists and bombs?

In October an al-Qaeda suspect was found inside a Canada-bound container in an Italian port. The container had arrived from Egypt. Police found a man equipped with a laptop computer, a mobile telephone, a bed and enough food and water for the long sea voyage to Halifax. Airport plans, security passes and an aircraft mechanic's certificate were also found.

The idea of the container as a terrorist Trojan horse predates September 11th. A Department of Transportation study in August 2000 gave warning that terrorists could smuggle in nuclear-bomb components on a ship or aircraft or in a container. The same scenario was painted in 1996 in a war game called Wild Atom, organised by the Washington-based Centre for Strategic and International Studies.

The boxes are preceded or, often, pursued by paperwork, increasingly electronic, detailing cargo, shipper and receiver. The customs service physically inspects only 2% of containers but claims it uses “sophisticated targeting”, based on computer analysis of cargo documents. It is now developing more powerful analytical systems to work alongside the x-ray machines and mobile radiation detectors being supplied to customs officials.

Next week the United States will use a meeting in London of the International Maritime Organisation, the UN organisation that oversees the oceans, to promote a controversial scheme to extend its own borders. Under this plan, America would install its own security checks at the top ten foreign ports from which it receives containers. It would then use them as exclusive gateways to America, squeezing out smaller, non-authorised ports, unless they too submit to America's heavy and expensive security checks. The small cost of being safer: it would change the trade routes of the world, affecting thousands of companies with global supply chains and disrupting globalisation in a way that Osama bin Laden could only dream of.

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Citizens' initiatives

A watchdog who got watched

Feb 7th 2002 | SEATTLE
From The Economist print edition

Until this week, whenever a certain watch salesman said "Jump", politicians in Washington state asked "How high?" Now he is hopping a bit himself

AP

The permanent offender

IT LOOKS a clear case of the biter bit. For the past few years, the most feared figure in Washington state politics has lived 100 miles away from the capital, Olympia, in the waterfront suburb of Mukilteo, north of Seattle. Tim Eyman, a chatty 36-year-old who makes a comfortable living selling engraved watches to college students, is the brains and the mouth behind a series of successful ballot initiatives. Now he has had to admit that some of the money that should have gone into those campaigns has ended up in his own pocket.

In the 24 states that allow them (including Oregon, California and Michigan), citizens' initiatives got their start nearly a century ago, as a way of giving the voters more clout than corrupt political machines. In the 1970s a group of Californian tax-cutters used initiatives to rewrite local government. Mr Eyman and his group, Permanent Offence, seized on them as a way of holding his own state's politicians accountable for their use of tax dollars.

His first success came in 1999, with an initiative that got rid of the state's tax on car licence plates—which averaged about $600 a year on cars worth more than $25,000—in favour of a flat fee of $30 a year. Another initiative aimed at reducing property taxes was also approved by voters, but was deemed unconstitutional by the state's Supreme Court. Undaunted, Mr Eyman revised the proposal, and saw it pass overwhelmingly last November, to the fury of many elected politicians.

On February 1st, the *Seattle Post-Intelligencer* revealed that Mr Eyman had paid himself some $45,000 of the money raised for the November initiative. Technically, his "salary" was not illegal, but the news was seized on by the "corrupt" politicians he so often criticises. To make things worse, Mr Eyman at first denied the accusation. He now admits it is true ("I was in lie mode") and will think again about paying himself $157,000 this year.

On February 6th, the state's electoral overseer filed an official complaint against Mr Eyman. Permanent Offence will decide whether to replace him, but for the moment his power seems to be surviving. In particular, he is still holding hostage a proposed petrol tax that would finance $8.5 billion in state transportation projects. The tax is supported by the state's governor, Gary Locke, along with his fellow Democrats who control the House and the Senate. Seattle's traffic tie-ups are almost as bad as those of Los Angeles. There have been dark hints from people at Boeing that manufacturing work on the Sonic Cruiser, a high-speed airliner, will move out of the state unless traffic between Boeing's factories around Seattle gets unclogged.

The Democrats would like to decide the issue in Olympia. But Mr Eyman has threatened to organise a referendum to overturn any petrol-tax increase introduced without a state-wide vote. The state's Republicans are largely in Mr Eyman's camp. The governor talks bravely of his right to leadership, but has made little headway in forcing a vote in the legislature, and it still seems pretty likely that the question will be settled by a referendum.

Such a vote will pit those who want a better state-wide transport system against recession-hit voters who would prefer to save six to nine cents a gallon on petrol taxes. The likely winner? The pennies—and, of course, Mr Eyman.

Critics of citizens' initiatives say they have this effect only too often. Mr Eyman's licence-tax initiative, though described as “populist”, clearly favours the Mercedes-Benzes of the well-off, but leaves people who drive rusty old bangers paying about as much as before. Last year's initiative to freeze property-tax increases at 1% a year has actually caused a sharp increase in many property taxes. A number of cities and counties had not increased taxes at the rate allowed by state law, reckoning they could push them up later. Now, with a 1% limit looming, they have decided it is time to grab the extra cash.

Defenders of Mr Eyman point out that he has been, until this week, an astute judge of the public temper, and a skilled finger-pointer at the emperor's scanty wardrobe. The licence tax, for instance, caused deep resentment because of a formula that taxed many cars at considerably more than their actual value. And his criticism of state transportation plans has proved embarrassingly accurate: witness the cost overruns, and changes of mind, in a proposal to build a $2.1 billion, 14-mile light rail system in Seattle. His methods, though called “political blackmail”, are hardly worse than Boeing's sword-rattling.

So he will not go easily. And, even if he did, there would be plenty of other Permanent Offenders waiting to take his place.

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Lexington

Paul Wolfowitz, velociraptor

Feb 7th 2002
From The Economist print edition

Clever, quick and jumping for the throat

MOST deputy secretaries live lives of quiet frustration. They get stuck with all the grunt work while their bosses swan around in the limelight. And they have to sit mutely by while their best ideas are either buried or stolen. Not Paul Wolfowitz, number two at the Pentagon. Mr Wolfowitz is second-in-command to Washington's biggest gun, Donald Rumsfeld, in one of the most sensitive areas of policymaking. Yet his influence seems to grow by the day.

A few days after September 11th Mr Wolfowitz broke two of the cardinal rules of this control-obsessed administration. He not only created a media firestorm by raising the idea of “ending states who sponsor terrorism”. He also found the secretary of state contradicting him, in one of the administration's worst public rows. Yet last week it was Mr Wolfowitz's fingerprints, not Colin Powell's, that were all over the state-of-the-union speech. Its commitment to tackling explosively unpredictable dictatorships, alias “rogue states”, its unabashed enthusiasm for asserting American power, its insistence that this involves a desperate race against time: all are classic Wolfowitz themes.

Mr Wolfowitz's shy manner and solemn qualifications suggest just another identikit member of the global establishment. His career includes spells as head of the Johns Hopkins School of Advanced International Studies and ambassador to Indonesia. But his views mark him out as a rather more interesting creature. He believes in building a missile-defence shield, in preventing China from becoming a regional hegemon, in using human rights as a weapon in foreign policy; in short, he is every timorous European's worst nightmare. “Hawk doesn't do him justice,” says one former colleague. “What about velociraptor?”

Mr Wolfowitz is the leader of a small group of foreign-policy neo-conservatives who have been hanging around Washington since the 1970s. They criticised the realpolitik approach to foreign affairs championed by Henry Kissinger for accepting the cold war's status quo and for implying that there was a moral equivalence between the Soviet Union and the United States. They argued that America should be much more willing to champion its values, insisting that this would advance, not threaten, global security. The biggest threats to America's security were regimes based on values that America, and other free countries, deplore; change those regimes by advancing western values and—hey presto—you strengthen American security.

Mr Wolfowitz's muscular world view was forged in the groves of academia rather than the paddyfields of Vietnam, a fact that infuriates Mr Powell. After switching from mathematics to political science, he came under the influence of two remarkable mentors. Allan Bloom (later famous as the author of “The Closing of the American Mind”) persuaded him that political regimes play a key role in shaping character. Hence his enthusiasm for changing governments. (Mr Wolfowitz appears, lightly disguised, in Saul Bellow's novel about Mr Bloom, “Ravelstein”.) Albert Wohlstetter educated him in the arcana of cold-war strategic thinking. The result: a political moralist, with a policy wonk's appetite for the numerology of missiles.

An intense interest in ideas does not make him the most natural member of an administration dominated by businessmen and professional politicians (Mr Bellow is not the writer of choice in the Texan oil industry). But three things have given Mr Wolfowitz a large amount of influence. The most obvious is personal connections. Mr Wolfowitz was Dick Cheney's right-hand man when the latter ran the Pentagon. He worked for Mr Rumsfeld twice before moving to his current job—as a foreign-policy strategist when Mr Rumsfeld ran Bob Dole's 1996 presidential campaign, and as a member of the 1998 Rumsfeld

Commission, which gave warning of America's vulnerability to attack by long-range ballistic missiles. Richard Perle, an old friend, is chairman of a Pentagon committee. John Bolton, another star warrior, sits in the heart of Powell territory, the State Department. “Scooter” Libby, Mr Cheney's chief-of-staff, is known as “Wolfowitz's Wolfowitz”. The *Weekly Standard* provides an influential megaphone for Mr Wolfowitz's views. (One of the magazine's former writers, David Frum, coined the phrase “axis of evil”.)

The second thing is persistence. Nothing seems to deter Mr Wolfowitz from banging his favourite drum. A lengthy series of articles in the *Washington Post* on the administration's response to September 11th presents him as a man in the grip of an *idée fixe*, prepared to turn up to meetings that were reserved for principals, interrupt his boss, and bring up the subject of Iraq at the drop of a hat. After one meeting, Mr Bush made it clear that he wanted only one person to speak for the Defence Department.

But the most important reason is that history has moved in his direction. Mr Wolfowitz has been arguing for years that the world is a far more dangerous place than most people realise; that America needs to increase its military expenditure; and that the best form of defence is offence. September 11th may not have proved him right in every detail. There may be no connection between Saddam Hussein and the September 11th atrocities. Rogue states don't form anything so coherent as an axis. But everybody now understands the premise.

The velociraptor has been right before. In the 1980s Mr Wolfowitz vigorously supported Ronald Reagan's denunciation of the Soviet Union as an “evil empire”—a phrase the conventional-minded of the time regarded as bonkers. His willingness to trust his intellect against the weight of conventional opinion is admirable. Still, he has to remember that, in this war especially, realpolitik, diplomacy and even those carping Europeans have a role. America cannot fight a multi-pronged war on terrorism without enlisting the support of other countries; and it is easier to fight a war in support of western values if you have the support of other western countries. Seeing the future is only half the battle; you have to persuade other people to see it too.

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Argentina's crisis

Floating into the unknown

Feb 7th 2002 | BUENOS AIRES
From The Economist print edition

Reuters

The government's new economic plan is a step forward. But it has many flaws, and things may get worse before they get better

IT IS an article of faith among some economists that Argentina's past history of monetary irresponsibility means its people think in only one currency: the dollar. That makes the economic plan announced by Jorge Remes Lenicov, the economy minister, on February 3rd a considerable risk. The plan involves not only floating the peso, after more than a decade at which the currency was pegged at par to the dollar, and enduring a month with an officially manipulated dual rate. It also decrees the transformation of a largely dollarised economy into one that must work in pesos.

The official hope is that the plan will stop Argentina's economic and political implosion, and lay the foundation for recovery. Critics fear that it will plunge the country into inflationary chaos. They complain, too, that it is generous to debtors at the cost of savers and taxpayers.

Dismantling the fixed-exchange-rate regime was never going to be easy. When he took power on January 1st as Argentina's fifth president in a fortnight, Eduardo Duhalde inherited a freeze on most bank deposits (known as the *corralito*, or fence), which has enraged the middle class and plunged the economy into free-fall (see chart), raising fears of widespread social unrest. After flirting with unorthodox measures such as the dual exchange rate, Mr Duhalde's team has now moved closer towards adopting the "coherent" plan urged upon them by the IMF and sundry outsiders, including the Bush administration. The government's hope is that once this year's budget is approved (Congress began debating it this week), officials will start negotiations with the IMF on a loan agreement. "For Argentina to carry out a reasonable foreign-exchange policy and to progress with freeing savings, international support is essential," says Mr Remes.

Many details have still to be worked out. The re-opening of foreign-exchange markets was postponed from February 6th until next Monday—to give the Central Bank time to draw up new regulations, Mr Remes said. Even so, the plan has some obvious flaws. If inflation is not to take off, freeing the currency needs to be combined with tight monetary and fiscal policies. On paper, the government is committed to these. The Central Bank will print no more than 3.5 billion pesos this year. The budget maintains a 13% cut in public-sector wages and pensions imposed last year,

increases spending only on emergency help for the poor, and forecasts a fiscal deficit of just 3 billion pesos, down from 10 billion pesos (then, $10 billion) last year.

But the Central Bank lacks both genuine independence and an inflation target. And in the face of political pressures, the government may find that the easiest way of sticking to its budget is to let inflation reduce the value of spending. It has put off needed structural reforms of provincial finance and the state, although it does plan measures to slim the cost of politics. “To regain confidence, you need to do reforms now,” says Juan Jose Llach, an economist at Austral University.

A second problem concerns the banks. Mr Duhalde has broken his original, rash, promise to repay dollar savings in dollars while turning dollar loans into pesos. All dollar loans (around 70% of the total) are now being turned into pesos at par—a generous gift to those companies with loans who hold dollars abroad. But dollar savings are being converted at an exchange rate of 1.4 pesos to the dollar, and will then be indexed to inflation. Banks will be compensated for the resulting hole with government bonds. In all, reckons Pedro Lacoste, an economic consultant, propping up the financial system may require the government to issue new debt of $20 billion. But the government has already defaulted on most of its existing debt.

The immediate test for Mr Remes's plan is how far and fast the peso depreciates. Several things may serve to brake its fall. Because of the *corralito*, Argentines have little cash to buy dollars. The Central Bank still has $14 billion of reserves. But on the other hand, few Argentines have any confidence in their government—or in any of their politicians, for that matter.

This in turn, means that Mr Duhalde, who lacks a popular mandate, has an uncertain grip on power. He can count on the support in Congress of most of his own Peronist party and of much of the opposition. His party machine has a long experience in calming the poor with patronage; but cash for this is now tight, and unemployment may have reached 25%. He faces the noisy hostility of much of the middle class, whose pot-banging demonstrations against the *corralito* helped to bring down two of his predecessors. And he has embroiled himself in a new political battle against the Supreme Court, which has declared the *corralito* unconstitutional. The president has responded with a decree banning further legal challenges to the savings freeze, and the government coalition in Congress is moving to impeach the court. Although the judges are tarnished by corruption claims, this battle will not enhance the government's legitimacy.

But Mr Duhalde's fate, and Argentina's, is likely to be determined by the government's success or failure in freeing the currency without triggering hyper-inflation. If it succeeds, Argentina could start recovering later this year. Failure might mean the de facto adoption of the dollar, the fall of the government, and more chaos. The next few weeks will be decisive.

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Colombia's peace process

Not looking good

Feb 7th 2002 | BOGOTA
From The Economist print edition

The FARC carries on regardless

Get article background

EPA

On the road to Apulo

AT FIRST, Colombians were hugely relieved. On January 20th President Andres Pastrana decided, after some last-minute brinkmanship, to renew the decrees which conceded to the Revolutionary Armed Forces of Colombia (FARC) a huge demilitarised enclave of 42,000 square kilometres in the south of the country. The agreement with the country's largest guerrilla group also set a tight agenda for reaching a ceasefire by April. After three years of drifting talks and continuing violence, respite seemed in sight.

No longer. Although ceasefire talks are continuing in the FARC's enclave, the 18,000-strong guerrilla force has stepped up its campaign across the rest of the country. More than 40 soldiers, police and civilians have been killed in the past two weeks, including five in a bomb explosion in Bogota on January 25th. On February 6th, a huge car bomb was defused in Medellin. Many recent attacks have been in urban areas, raising fears that the rebels are taking their war to the cities, where three-quarters of Colombians live. The guerrillas have also attacked power lines, bringing down more than 50 pylons and causing blackouts in three regions.

Mr Pastrana wants American military aid, which is currently dedicated to arming and training Colombian anti-drugs forces, to be used also to protect such things as oil pipelines. Attacks by a smaller guerrilla group, the National Liberation Army (ELN), on the Cano Limon-Covenas pipeline prevented Occidental Petroleum from pumping over 20m barrels last year, more than half its capacity. The Colombian government has already received $1.3 billion from the United States over the past two years for anti-drugs operations. Another $625m should be forthcoming unless Colin Powell, America's secretary of state, decides within the next month to suspend assistance on human-rights grounds. On February 5th Human Rights Watch and Amnesty International called on him to do just that, claiming that Colombia's armed forces were continuing to collaborate with the country's brutal right-wing paramilitary groups. But without American aid, both the guerrillas and the paramilitaries may well get stronger. On February 6th, the FARC demanded an end to Plan Colombia, the American-backed anti-drugs offensive, and the expulsion of all foreign military advisers.

Meanwhile, after a five-month suspension, the government resumed peace talks last week in Cuba with the ELN. Analysts say this group, which has no more than 5,000 fighters, represents Mr Pastrana's only real hope of striking a peace deal before he leaves office. But three days of talks produced no more than a well-meaning but woolly commitment to carry on.

Ordinary Colombians are fed up with all this. In May, they must elect a new president. The latest polls give Alvaro Uribe Velez, the most belligerent critic of the peace process among the seven presidential candidates, a nine-point lead over Horacio Serpa, the more dovish leader of the opposition Liberal Party. A former governor of the department of Antioquia, Colombia's economic powerhouse, he is accused by some of being too close to the United Self-Defence Forces of Colombia (AUC), the paramilitary umbrella group responsible for most human-rights abuses, though he denies this. But in a country crying out for order, Mr Uribe has struck a chord with voters. He has promised that, unless hostilities end completely, the armed forces will retake the FARC's enclave on the day he becomes president.

Whether his popularity lasts will depend largely on the FARC. James LeMoyne, the former journalist who, as the UN's representative for Colombia, was credited with reviving the peace talks last month, thinks that the FARC's current offensive is mostly a short-lived show of strength after their agreement to ceasefire talks. If this is so, Mr Uribe's chances of winning the presidency may subside as the violence does. But if the FARC's offensive endures, the volatile loyalties of the Colombian electorate may switch definitively to the hawk rather than the doves.

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The World Social Forum

Meanwhile, in another world

Feb 7th 2002 | PORTO ALEGRE
From The Economist print edition

Bigger, yes. But any more influential?

AP

Stock villain number one

LAST year, protesters trashed a McDonald's restaurant and wrecked a multinational's plantation of genetically-modified crops. This year's World Social Forum, an anti-establishment counterpoint to the World Economic Forum in New York, was both more crowded—51,000 delegates, three times as many as last year, the organisers claimed—and more sedate. Delegates, gathering for a second year in the southern Brazilian city of Porto Alegre under the banner "Another world is possible", aimed to prove that they are not just noisy rebels but can offer alternative policies to create a fairer, greener world.

"We don't just oppose any more, we propose," said a panellist at the start of a debate on "International Organisations and the Architecture of World Power". But despite exhortations from the chairman (sorry, "animator") for more specifics, three hours of talking produced little detail on what should take the place of those stock villains, the IMF, World Bank and World Trade Organisation, and how their replacements would be financed. That old favourite, a worldwide tax on financial speculation, was suggested. Speakers wasted much time on whether, since they object to their movement being called "anti-globalisation", the term "de-globalisation" would do. How about "earth democracy"? mused one.

The forum undermined its self-professed democratic credentials by rejecting the World Bank's offer to send an official to debate and (pushed by the French left, who helped organise the forum) by turning away Guy Verhofstadt, Belgium's centre-right prime minister. Although Mary Robinson, the United Nations' human-rights commissioner, paid a visit, as did several French presidential candidates, few heavyweight politicians attended.

Anxious to avoid being labelled as extremists in the wake of September 11th, the organisers this time left Colombia's FARC guerrillas off the guest-list. Nor did they invite José Bové, a French farmer famous for attacking a McDonald's back home, who was the star of last year's conference for his efforts to destroy genetically-modified crops. He came anyway, and behaved himself this time.

Though Susan George of ATTAC, one of the forum's founding organisations, told delegates that they represent up to 90% of the world, voters do not seem to agree. Just look at recent elections in Latin America. Last June, Peruvians rejected Alan Garcia, a left-wing former president, and chose Alejandro Toledo, a centrist former World Bank economist who has put a former IMF official in charge of the economy. (Mr Toledo went to the meeting in New York, not the one in Brazil.) In October's congressional elections in Argentina, despite the country's gathering crisis and revulsion against its political establishment, little progress was made by those representing leftist, alternative policies.

In November, both Honduras and Nicaragua chose conservative businessmen as their presidents, as Mexico had done in 2000. In places like Chile, moderate centre-left groups have won elections by promising to continue orthodox economic policies. Apart from Cuba's Fidel Castro, the region's leading anti-orthodox figure is Venezuela's Hugo Chavez, whose "Bolivarian revolution" has been disastrous and faces increasing public anger.

And what of the forum's hosts, Brazil's left-wing Workers' Party? Although its leader, Luiz Inacio Lula da Silva, leads the polls ahead of this October's presidential elections, Roseana Sarney, a conservative pro-

government candidate, has been catching up. Mr da Silva and his aides are doing their utmost to project a “left-lite” image and, in his speeches to the Porto Alegre forum, he disappointed some delegates by rejecting re-nationalisation, debt defaults and trade protectionism.

The speakers at Porto Alegre, like those in New York, were preaching to the converted. Last year, a televised link-up between the two forums ended with a protester at the Brazilian end screeching “Child killer!” at George Soros. This year, no link-up happened. But other sorts of dialogue are being encouraged. Kofi Annan, the secretary-general of the United Nations, visited the New York gathering and sent a letter to Porto Alegre. Among the delegates at Porto Alegre was Tom Spencer, a former British MP, whose group, the Commission on Globalisation, has invited key figures from both sides to sit down, out of the limelight, and try to find common ground. Relieved of the bother of having to play to their respective galleries, he reckons, they may get somewhere.

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Chile's defence policy

Copper-bottomed

Feb 7th 2002 | SANTIAGO
From The Economist print edition

A very strange way to pay for an army, a navy or an air force

WELL-packed with men but short of ships, planes and guns, Chile's armed forces urgently need modernisation. But by agreeing to purchase new F-16 fighter planes without first sorting out the defence budget, the government has made that job harder.

When President Ricardo Lagos took office in March 2000, he promised to review an inefficient arrangement under which Chile's armed forces receive an off-budget allocation from Codelco, the state-owned copper company, to finance purchases of equipment. Instead, by agreeing to acquire ten Lockheed Martin F-16s from the United States at a cost of $660m, the government may have locked the arrangement in place until 2009, when the air force will finish paying for the planes.

The allocation, introduced in the 1950s but increased during the dictatorship of Augusto Pinochet in 1973-1990, transfers 10% of Codelco's export returns directly to the armed forces. By law, the allocation cannot be trimmed or diverted to other uses and must be pumped up if it falls below $225m, thus undermining the government's control of military spending. The fund also goes up and down with the copper price: after rising to around $341m in 1995, it fell to around $235m last year. In addition, because the money is split equally between the army, the navy and the air force, the purchases of each branch are determined by how much cash is available, rather than by any proper set of defence priorities.

The arrangement is one of the reasons why the government has postponed indefinitely—and almost certainly scrapped—the navy's proposed purchase of four new frigates from Germany's Blohm+Voss. Because the navy still has to pay for two Scorpene submarines from DCN-Izar, a French-Spanish consortium, the frigates, estimated to cost $1.25 billion, would have tied up its copper allocation for almost 20 years.

Reforming the copper allocation will be a long job, but analysts wonder why, in the meantime, the government did not buy second-hand aircraft instead. Chile, they say, could have got 16 refitted F-16s and four frigates for $550m, improving defence capacity more markedly and at a lower cost than by buying the new aircraft. Although the government denies it, Chile's current negotiations for a free-trade treaty with the United States may have inclined it to buy brand-new ones.

The purchase is particularly surprising because, although the air force needs new planes, the navy needs new ships much more. By 2010, the entire surface fleet will be obsolete. Without new frigates, the gap will have to be plugged with second-hand acquisitions. Ships also have a peacetime role—protecting fisheries, controlling drug-trafficking—that the government considers vital to overall defence. By contrast, since Chile's relations with its neighbours are pretty good at present, the only outing the F-16s are likely to get is at the annual military parade in September.

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Polling in the largest state

Caste adrift in India

Feb 7th 2002 | HARDOI AND LUCKNOW
From The Economist print edition

Election manoeuvres in Uttar Pradesh

Get article background

NARESH AGGARWAL is a popular man in the Hardoi district of Uttar Pradesh, India's largest state. As the state's energy minister, he made sure that blackout-free electricity reached even the most rustic quarters of his constituency. Last year, after the government sacked him for disloyalty, power supply reverted to the sporadic norm, to the disgust of farmers, who must now irrigate their fields with pumps driven by more-expensive diesel. Mr Aggarwal has switched to the leading opposition party and is now campaigning for re-election in the state poll, to be held on three days between February 14th and 21st, along with elections in Punjab and two smaller states. He looks likely to win.

Mr Aggarwal's story tells you three things about Uttar Pradesh: party loyalties are fleeting, crude patronage masquerades as good performance in office and the opposition has a good chance of winning. Its victory might matter more to people outside the state than to those within it. Uttar Pradesh—or UP, as everyone calls it—is vast. Its population of 166m would make it the world's sixth-largest country. With an income per person of around $220 a year it would be the poorest of the six, putting it on a par with Chad.

UP's ruling party, the Bharatiya Janata Party (BJP), also leads India's coalition government in Delhi. If it loses power in the state, its grip on the centre will be loosened, though not removed. UP's masses may not notice much change. The main reason is that politicians' notion of welfare is not general but particular. Parties “only seek to redistribute the spoils of office to favour one group over another”, writes Zoya Hasan, a political scientist at Jawaharlal Nehru University in Delhi.

Mr Aggarwal, who has spread favours around his constituency, has a wider vision than most politicians. Many care for little beyond their own pockets. Dozens of candidates in the race for the state assembly's 403 seats are facing criminal charges. Their muscle can secure a seat when appeals to voters' caste, ideology and self-interest are not enough. Perhaps in protest, more than a dozen eunuchs, a despised but assertive group, are running for office.

Caste considerations are what draw the masses into this democratic scrum. The BJP's base is among upper castes, which make up about a fifth of UP's population. Its main rival, the Samajwadi (Socialist) Party, relies on an alliance of Yadavs, a relatively prosperous lower caste, and Muslims, who account for 18% of UP's population. The performance of two lesser parties may decide who holds sway in Lucknow, UP's capital. They are the Bahujan (Majority) Samaj Party (BSP), which champions Dalits, formerly untouchables, and the Congress party, once unchallenged ruler of UP (and India) and now a weakened fourth force in the state.

If the BSP does well enough it is expected to back the BJP, though its Dalit leader, Mayawati, might demand the chief ministership in return. Congress could be junior partner to the Samajwadi Party. Caste borders are porous, and parties are trying harder than usual to cross them. The chief minister, Rajnath Singh, thought up the idea of reserving government jobs for the “most backward castes”, groups of lower castes and Dalits supposedly neglected by other parties. Unfortunately for Mr Singh, most of the potential beneficiaries are too benighted to have heard of the proposal while the likely losers are not. The BSP is putting up Muslims and upper castes as candidates for nearly half the seats. This does not point to a weakening of caste calculus, says Yogendra Yadav, a political scientist at the Centre for the Study of Developing Societies in Delhi. Rather, it shows that parties are sure enough of their traditional supporters that they can risk poaching others'.

Ideology and competence matter less. Congress and the Samajwadi Party, which depend on Muslim support, are fierce foes of the BJP's idea that the culture and rights of India's Hindu majority need special protection by the state. But the BJP is downplaying its signature issue, the building of a Hindu temple at the birthplace of the god Ram in Ayodhya, 140km (90 miles) east of Lucknow, where Hindu activists tore down a mosque ten years ago, a campaign that triggered bloody inter-communal clashes. Ideologues affiliated with the BJP have said construction will start after March 12th, and 43% of UP's people want the temple built, according to an opinion poll. But the issue no longer swings votes. “For us, progress counts,” says a mason from Hardoi, although he supports building the temple. UP, part of India's laggard “cow belt”, has seen too little of it. GDP per person grew more slowly in UP during the 1990s than in all but one of India's 14 big states, though performance improved in the second half of the decade.

The state's massive fiscal deficit, partly a result of the corruption and patronage that grease the political system, has throttled spending on education, health and other basics. Among big states UP has the highest infant mortality rate, the third-lowest literacy rate for women and the second lowest percentage of childbirths assisted by a health professional. The state's high court observed that “no rule of law is prevalent” in UP and that criminals with money or political clout can evade justice.

Such considerations sway the 29% of voters who, according to the opinion poll, count themselves consistent backers of no party. A year ago their disgust with the BJP had most pundits predicting that it would be trounced in UP and humiliated in Delhi. But Mr Singh, who became chief minister in 2000 and is reckoned a relatively competent administrator, has lured back many disaffected BJP voters, giving his party a chance. Its share of the vote is expected to be close behind that of the Samajwadi Party, though its share of seats may lag further. This would be awkward for the BJP in Delhi, where it heads a coalition of 19 parties. If the BJP lost UP, it would then govern just one big state, Gujarat, which it may lose next year. Its coalition allies would not be keen to bring the government down, since that would mean an unpalatable choice between allying with Congress, the main opposition party at the centre and their rival for power in several states, or facing new elections. But they might chip away at the BJP's authority as they manoeuvre for national elections due in 2004.

If the past is any guide, potential losers in UP will woo legislators from rival parties so insistently that they may end up winners. The BJP cobbled together a majority four years ago by arranging splits in the opposition. It might do so again. That would injure democracy, but bring smiles to India's rulers in Delhi.

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Privatisation in India

An incredible shrinking government

Feb 7th 2002 | DELHI
From The Economist print edition

The state holds a sale

ECONOMIC reform in India normally moves at an elephantine pace, but on February 5th the pachyderm pounced. In a series of measures, some long promised, the government gave its clearest signal in a long while that it is serious about getting out of the economy's way. They include the privatisation of several state-owned companies, an end to restrictions on the stocking of some agricultural commodities and a plan to shed excess government manpower.

Some of this deserves to be quibbled with, and much more remains to be done, but the package looks bold, especially a week before crucial state elections. Ignoring one of the hoariest taboos, the government announced a slew of privatisations, the most important of which is the sale to India's Tata group of a 25% stake in (and management control of) VSNL, which has a monopoly of international telephony until April 1st. This is part of a telecommunications reform that has introduced competition to most parts of the market. The cost of mobile-phone calls has fallen by 90% over the past three years; national long-distance rates dropped 60% last month with the advent of competition. International rates are expected to follow soon.

Less impressive is the sale of IBP, which owns a string of petrol stations, to the big public-sector Indian Oil Corporation. This is not true privatisation, and critics worry that the deal will stifle competition in the distribution of petroleum-based products. The sale of the two companies (plus some hotels) will bring the government's privatisation receipts for the fiscal year ending in March to about 31 billion rupees ($640m), far less than its 120 billion rupee target but more than many expected it to earn.

At the same time, the government has begun to gut the 1955 Essential Commodities Act, which allows the state to immobilise several types of goods, including food, as a defence against scarcity. A dozen items, cement and yarn among them, are to be removed from the list of 29 governed by the act. More important is the removal of restrictions on storage and movement of grain and sugar, which should improve farmers' access to markets and encourage private investment in distribution.

Finally, the government will offer attractive early-retirement packages to 1m excess staff. There are still plenty of public-sector companies to be sold and restrictions on agriculture to be abolished. Sompal, a member of the government's Planning Commission, points out that continued restrictions on some farm exports and licensing of such activities as making flour make no sense. In telecommunications, India needs a regulator that can keep up with the market. But the government has given reform-minded sceptics a rare pleasant shock. It will have a chance to shock them again with its budget at the end of February.

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The Koreas and the United States

Sunshine and ice

Feb 7th 2002 | SEOUL
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A mixed welcome for George Bush

EPA

Bad news for Han

WITH George Bush's first visit to South Korea less than two weeks away, foreign ministry officials in Seoul are trying to find ways to persuade him to soften his stance towards North Korea. They may not succeed. They are aware that the American president remains determined to fight against the forces of terrorism wherever he believes they exist. He sees little good in a country that starves its people while making and exporting missiles. Mr Bush's state-of-the-union speech on January 29th linked North Korea with Iraq and Iran into an “axis of evil” even though he would have been advised this could embarrass the South Korean president, Kim Dae Jung, who has sought reconciliation with the North. The most encouraging words the South Koreans have received from Washington since then is a comment by the secretary of state, Colin Powell, that the United States was “willing to talk” to North Korea. But the diplomatic Mr Powell may not be reflecting the views of others around Mr Bush.

Mr Bush's officials will, however, no doubt be worried by threats by activists in Seoul to disrupt the president's three-day visit planned to start on February 19th as part of a tour that will also include Japan and China. Quite respectable Koreans have been upset by Mr Bush's speech. Five MPs from government and opposition parties delivered a letter to the United States embassy on February 6th. One of them said that the speech threatened to harm stability on the Korean peninsula.

On February 4th, Mr Kim sacked his foreign minister, Han Seung Soo. Officially, Mr Han resigned to comply with Mr Kim's promise to remove members of parliament from his cabinet so as to form a neutral government ahead of this year's local and presidential elections. But some commentators suspect that he lost his job after failing to smooth differences of view between America and South Korea on ways of dealing with the North.

Although Mr Kim frequently shuffles his cabinet, and few ministers in his administration have served more than one year, Hong Soon Young, the unification minister, who has also been sacked, held the job for only five months. He may have sinned against Mr Kim's “sunshine” policy by being too firm with the northerners during the inter-Korean ministerial talks last November. The meeting was to agree on dates for another round of talks. The North would not comply and blamed Mr Hong for the breakdown in negotiations.

Mr Kim is unlikely to stop trying to spread sunshine on the peninsula. He has a new unification minister, who, presumably reflecting Mr Kim's own view, has said in public that the North's nuclear and bio-chemical weapons may not be aimed at the South. The government is lending 90 billion won ($70m), with suspended interest payments, to Hyundai to help it pay the North its fee for allowing southern tourists to visit Mount Kumgang, famous for its scenery.

Will these friendly gestures be enough for the North to resume official contacts with the South? Maybe not. As long as American-North Korea relations remain icy, inter-Korean relations may not move forward. South Koreans (and North Koreans) will provide Mr Bush with an attentive audience.

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Race in Singapore

Veiled threats

Feb 7th 2002 | SINGAPORE
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Multiculturalism begins to fray

AP

Not such a small issue

IN ONE sense, Zulfikar Mohamad Shariff is the perfect Singaporean. He is part Chinese, part Malay and part Indian, rather as the population divides. But in the government's view, he makes a poor role model, since he has stirred up the sensitive issue of race relations. On a website he used to edit, he accused the government of ignoring the feelings of the Malay Muslim minority, both by its co-operation with the United States during the war in Afghanistan, and by its refusal to allow Muslim girls in state schools to wear the traditional *tudung*, or headscarf. What with the uproar prompted by the arrest of 13 Malays in December on suspicion of planning an anti-American bombing campaign, and the suspension of two veiled schoolgirls on February 4th, the government's vision of a harmonious, multicultural society is beginning to fray.

The government suspects people such as Mr Shariff of trying to harness the *tudung* issue to further their ideas about foreign policy. It is digging its heels in, officials say, to prevent such radicals from seducing mainstream Malay opinion. Anyway, if schools began modifying their uniforms for students of different religions, they argue, every group from Buddhists to Seventh Day Adventists would suddenly produce special demands.

Yet the government already makes one exception, by maintaining a colonial policy permitting Sikh students to wear turbans. The real problem, critics say, is Singaporean officialdom's knee-jerk rejection of all but the mildest dissent.

There is more to the row than that, however. Malays, who make up about 14% of the population, have less schooling and earn smaller salaries than the 77% of Chinese origin or the 8% of Indian ancestry. A far higher proportion work as labourers and clerks, and a lower one as managers and professionals. Some Malays believe that official prejudice prevents their rise to the top in the army and bureaucracy.

But Malays also benefit from state largesse. The government helps to pay for Koranic schools (complete with girls in *tudungs*) and mosque construction. The ruling People's Action Party (PAP) takes pains to recruit Malays: one of its MPs wears the *tudung* herself. Goh Chok Tong, the prime minister, likes to tack a few words in Malay on to the end of his speeches. But PAP officials fret that Malays remain frustratingly ill-integrated.

It is hard to see what the authorities can do about it. In contrast to Malaysia, where Malays get priority over Chinese for university places and the like, Singapore officially abjures any form of affirmative action. What is more, the government does not seem to know what role it wants race to play in Singaporean society. It encourages all its citizens to play down their differences, eschew racial politics and rub along together. Yet it says Singapore's strength lies in its diverse cultural heritage.

In some ways, it even promotes distinctions based on race. Schoolchildren must study their father's language, in addition to English. Government statistics regularly highlight the differences between races, as opposed, say, to income groups. And Singaporean identity cards all specify the bearer's race—which makes people like Mr Shariff a problem in more ways than one.

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Cambodia's local elections

Winning ways

Feb 7th 2002 | PHNOM PENH
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Hun Sen keeps a grip on power

EPA

How to vote, the more peaceful way

IN THEORY, Cambodia is a democracy run by the leader of the political party with the most seats in parliament. In practice, the prime minister, Hun Sen, runs the country by virtue of a monopoly of muscle, the readiness of thuggish subordinates to use it and a tight grip on the machinery and resources of state. Local elections on February 3rd, significant as a warm-up for National Assembly elections next year, did little to alter that equation. Mr Hun Sen's Cambodian People's Party (CPP), in power since Vietnamese troops threw out Pol Pot's Khmers Rouges nearly a quarter of a century ago, romped to a landslide victory. Partial results pointed to the CPP winning close to 99% of 1,621 local communes, although it will have to share power in some of these with opposition party members.

As the first local elections to be held in Cambodia since the 1950s, the vote marked one more step in an arduous journey back from decades of conflict to some semblance of normality. Polling drew 90% of voters and passed off largely peacefully. Local and foreign election observers said Mr Hun Sen's victory was acceptable. Campaigning, however, provided a more accurate measure of Cambodian political realities. Around 20 people died in politically-related killings in the run up to the vote, eight of them candidates of opposition parties.

The killings were only the tip of an iceberg of intimidation that discouraged any debate on even local issues. Along with the threats, the CPP also binged on gifts and other inducements to woo voters. State radio and television did their part, ignoring the campaigns of opposition parties. It has to be said though that Mr Hun Sen is not just Cambodia's toughest politician, he is also arguably its ablest and most hard working. He is of peasant stock and has a rapport with rural Cambodians.

The CPP campaigned vigorously for victory. To boost its flagging popularity, the party replaced close to a third of its commune chiefs with more popular candidates. Senior party officials assiduously toured the length and breadth of the country. Mr Hun Sen did not campaign—to preserve his neutrality, he said. He did not vote either. But as in previous election campaigns, he travelled about the country opening a road here, touring a government project there, generally reminding Cambodians which political leader is best placed to address their needs.

His rivals in the royalist opposition party, FUNCINPEC, helped his cause. Many voters felt betrayed by the party's about-face after elections in 1998, when it abandoned protests over the conduct of the polls to join the CPP in government. In this election it did little to repair the damage, failing to present a distinctive programme. Party officials grumbled that their leader, Prince Norodom Ranariddh, was more preoccupied with making a film than with the election campaign.

The smaller Sam Rainsy Party, named after its leader, fared better. It won six of 76 communes in the capital and a handful more in the countryside. Mr Sam Rainsy, a former finance minister, is well liked in Cambodia for his courageous attacks on graft in the ruling party and its other abuses and for vigorously taking up the cause of workers.

He says his party's gains in this poll will provide the springboard that propels him to greater success in next year's parliamentary elections. Possibly. This week's elections have loosened a little the CPP's exclusive control of local government, opening the way for a number of possible changes. A limited

decentralisation of government from Phnom Penh and a more local say in tackling local problems look possible. But unseating Mr Hun Sen, or even significantly weakening his powers, does not.

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Bangladesh's natural gas

Pipe dreams

Feb 7th 2002 | DHAKA
From The Economist print edition

A quarrel among the politicians

ACCORDING to Farooq Sobhan, president of the Bangladesh Enterprise Institute, the country stands at a crossroads. “It can either squander its natural resources like Nigeria, or it can emerge as an Asian tiger economy that will one day rival Malaysia or Thailand.” The optimistic Mr Sobhan says that all it needs is the right government management of Bangladesh's vast supplies of natural gas for the country to prosper beyond its dreams. “If it is done properly the entire economy will be transformed, benefiting everyone from the humblest rickshaw puller to the wealthiest industrialist.”

Bangladesh, the eighth most populated country in the world and among the poorest, could certainly do with the money. According to the United Nations, over a third of the population is below the poverty line. Both government and opposition agree that its natural-gas resources offer perhaps the only hope for a brighter future. A recent survey conducted by a team of Norwegian geologists revealed that the country has 20 trillion cubic feet of recoverable reserves, with the potential to produce another 40 trillion cubic feet.

But decisions about the best way to exploit this potential wealth have become entangled with the country's politics. The government has strongly hinted that it will soon allow multinational oil companies now developing the reserves, among them Unocal and Shell, to begin work on constructing a pipeline to export gas to India, which it notes is one of the biggest markets in the world for piped gas. It is also on the doorstep. Officials argue that a decision needs to be taken fast because India may instead use its close ties with the new regime in Afghanistan to import gas via pipeline from Iran.

Opposition politicians say that any move to sell Bangladeshi gas abroad would be akin to selling the family silver. It should instead be used to reduce domestic power shortages. Further, no sale should take place abroad unless the government can prove that it has 50 years of natural gas in reserve. The country is being exploited by the multinationals, they claim, and anyway should be wary of getting into bed with India.

Some members of the government agree with the opposition's assertion that India is a bullying regional superpower. Even so, say government ministers, the opposition Awami League has done an about-turn since it lost power in October. In government, ministers say, it supported selling the oil abroad and signed contracts with the multinationals that cannot be radically changed.

A quick sale does have appeal. It would provide a respite from the country's pressing economic problems, among them debt. Bangladesh's foreign-exchange reserves of just over $1 billion are at a seven-year low. The taka has recently been devalued, and as Tony Blair diplomatically pointed out during his recent visit, the government is six months behind in money owed to foreign oil companies as part of a joint venture to develop the gas reserves. A decision to proceed with the pipeline to India will stimulate more foreign investment, it is argued, and give the oil companies an incentive to seek more reserves. Furthermore it will offer Bangladesh much needed funds to develop its infrastructure and restore sometimes strained relations with India. “The issue is not really whether we should export the gas,” says Mr Sobhan, “it is whether or not the government can secure a good deal with India and the foreign multinationals.”

Even if the government announces a go-ahead, don't expect things to move too quickly. A pipeline will take at least three years to construct, and there are no concrete plans as to who will build it and pay for its upkeep. And the government's decision could be challenged in the courts.

The multinationals, who describe themselves as good corporate citizens in Bangladesh, argue that if a

natural-gas pipeline to India is constructed, it will provide jobs as well as dollars in foreign exchange. The pipeline could be also used for a fibre-optic cable between Delhi and Dhaka, which in turn would help to stimulate bilateral trade. A Unocal executive mused that the way things were going, the gas could sit in the ground for another 20m years. A long delay, even by Bangladeshi standards.

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Education in Hong Kong

Try spelling imperial legacy

Feb 7th 2002 | HONG KONG
From The Economist print edition

The former British colony is trying to transform its education system

WHATEVER else sustained the British empire for so long, it was not Britain's education system. Its modern one still performs relatively poorly by most international comparisons. And unfortunately it exported the shortcomings of its earlier versions to many of its colonies, with Hong Kong suffering more than most. Kai-ming Cheng, professor of education at the University of Hong Kong, has shown that in 1999, 23,000 candidates (18% of the total) sitting the major public examination at the end of secondary education in the former colony obtained no pass grades. They were “not fit for further studies and they are not employable.”

The defects in both Britain's and Hong Kong's education systems were disguised by the fact that most people were employed in the low-skill, mass-manufacturing sector that predominated in both countries. They did not seem to need much education. But in the past 20 years, Hong Kong and Britain have lost more jobs in manufacturing than anywhere else apart from South Africa. According to the World Bank, in 1999 only 20% of Hong Kong's workforce was in the manufacturing sector, and this is expected to fall even further to 16% in 2005. As Hong Kong has de-industrialised, its education system has been exposed as inadequate to compete in what educationalists call the “knowledge economy”.

The British woke up to this problem in the 1990s. Tony Blair's rallying cry for his first Labour government was “education, education, education”. And it is only since the handover of the colony to China in 1997 that the new Hong Kong government has started to tackle this aspect of the colonial legacy. Education reform is one of the few areas where the government of the special administrative region enjoys widespread support.

Not only is Hong Kong way behind most of its direct competitors in Asia, such as Singapore, but, more significantly, three decades after the Cultural Revolution smashed China's education system, the Chinese are catching up. In Beijing and Shanghai, more than 50% of those aged 18 to 30 enrol in higher education. In Hong Kong the figure is only about 30%.

In September 2000, Hong Kong's government published its reform proposals for the education system. The emphasis is now very much on a “lifelong learning society”, to enable everyone to acquire new skills even after they have left school. Hong Kong is aiming to get away from its old system of learning by rote, in which pupils were endlessly drilled for a few very academic exams. The emphasis now is on encouraging pupils to think for themselves, and to develop flexible learning skills that will enable 60% of 18-30 year olds to be in tertiary education by 2010.

The controversial “academic aptitude test”, taken at the end of primary school to select pupils for different secondary schools, has just been abolished. The amount of streaming in secondary schools has been reduced to minimise the need for more testing. And the government also wants to attract brighter people into the teaching profession. It has opened a new teacher-training campus with courses to degree level. Universities are also being encouraged to reform their first-degree programmes, to include more teaching of “generic skills” such as IT.

If Hong Kong is to retain its status as a major economic power in Asia, everyone is agreed that modernising the archaic education system is essential. A close observer of the problem, not usually given to exaggeration, said, “Hong Kong's survival is at stake.”

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Iran and America

How not to make a friend of Iran

Feb 7th 2002 | TEHRAN
From The Economist print edition

EPA

Reform-minded Iranians detect the work of their own hardliners, determined to prevent detente, behind George Bush's attack

Get article background

PREDICTABLY, Iran responded to its inclusion in George Bush's “axis of evil” with a mix of righteousness, dismay and reflexive abuse. But two observations stood out. Calumnies of this kind, suggested a statement by the largest of parliament's reform factions, tend to be visited on countries whose people “have despaired of the regime meeting their desires”. A spokesman for the government, which under Muhammad Khatami also wants reform, presented Mr Bush's remarks as evidence that, despite the government's clear stance, an “interfering minority is taking foreign-policy decisions”.

Although they fight on domestic issues, Iran's conservative establishment and the reformists gathered round President Khatami have until now spoken with roughly one voice on foreign policy. Presenting a united front to the world was a way of defending a common good: the honour and continuity of the 1979 Islamic revolution. If there is now a new discordancy, it suggests that some Iranians no longer consider that common good to be good.

Iran's domestic power struggle, a saga of tedious obstructionism that began when the reformists captured parliament two years ago, is gradually starting to erode revolutionary principles. Under constant attack from the conservatives, parliament is planning to stage a referendum on what people think of the authority of the country's all-powerful, but unelected, institutions. Even if such a bill is vetoed by one of those institutions, Iran would still have a new battleline, between today's theocracy, and what is beginning to look more like a liberal democracy.

Mehdi Karrubi, the parliamentary speaker, exemplifies the new spirit of confrontation. Not long ago, the speaker's timidly reformist proclivities, cleric's gown and good links with the conservatives made him the ideal person to broker deals between the two camps. No longer: he is now prepared to go on the offensive on the reformists' behalf. Yet his ideology remains opaque. He himself is always respectful towards Iran's supreme leader, Ayatollah Ali Khamenei, though some of the deputies he protects want his powers curtailed.

Many reformists blame ill-intentioned hardliners for upsetting Mr Bush. Since Mr Khatami came to power five years ago, he has tried to improve Iran's relations with the rest of the world. America remained the exception. But when Mr Bush

Just about everyone, except

began his war on Afghanistan, reformists saw a chance to build trust with America too.

for the American administration, seems to agree that Iran's post-September role in Afghanistan has been mostly constructive

Just about everyone, except for the American administration, seems to agree that Iran's post-September role in Afghanistan has been mostly constructive. Having helped the Northern Alliance to military victory, Iran had a hand in persuading its leader, Burhanuddin Rabbani, to abandon his hopes of running the country. When Ismail Khan, the self-appointed governor in Herat, threatened to boycott Hamid Karzai's inauguration, Iran's ambassador cajoled him into attendance. The same envoy is now trying to get Mr Karzai's cabinet to ratify Mr Khan's position. Iran is also prepared to help with nation-building. “Our work to stabilise Afghanistan”, says an official, “has only just begun.”

But Mr Bush prefers to concentrate on reports that Iran has helped al-Qaeda men to safety. If this is indeed so, the spoilers are no friends of Mr Khatami—and their mischief is small beer next to Iran's positive contribution. It is possible that the same mischief-makers, or people who think like them, had a hand in the sea-borne cache of arms, apparently bound for Palestine, that Israel seized last month.

It all makes great propaganda for Iran's enemies, in America and Israel, whose expressions of outrage give local hardliners a pretext to bash Mr Khatami's policies of detente. Small wonder that a swirl of conspiracy theories has been used to explain these embarrassments. Do Israel and Iranian hardliners share an interest in preventing an improvement of Iranian-American relations? Answer: Yes (and see the next article for Israel's contribution).

Iran's behaviour abroad, while by no means exemplary, has got better since Mr Khatami came to power. The country continues in a state of protracted crisis. Rather than quietly encourage the hobbled president, Mr Bush has made things harder for him. Yet Mr Khatami, besides enjoying the support of the vast majority of his people, understands, and agrees with, those “non-negotiable demands of human dignity” that Mr Bush adumbrated during his state-of-the-union address: “the rule of law, limits on the power of the state, respect for women, private property, free speech, equal justice, and religious tolerance.”

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Israel and America

Influence or confluence?

Feb 7th 2002 | JERUSALEM
From The Economist print edition

George Bush's hit-list could have been written by Ariel Sharon

EPA

Gloating? Me?

“MUSIC to Israeli ears,” is how Moshe Arens, a Likud Party elder, describes George Bush's “axis of evil” doctrine. The prime minister, Ariel Sharon, agrees: “Iran calls for the destruction of the state of Israel,” he told the *New York Times*. “That's why it was so important for President Bush to name it as sponsor of terror.” Visiting the United States this week, Mr Sharon is celebrating a moment of pure harmony in Israel's not-always-easy relationship with Washington. The president's hit-list—Iran, Iraq, North Korea, “and their terrorist allies”—could have been drawn up in Tel Aviv.

Was it? Is it the product of Israeli influence in America, as Iran, among others, claims? Or does it reflect an objective confluence of outlooks and interests between the superpower and its Jewish ally?

The answer, according to several wellplaced Israelis, is a bit of each. Israel has been plugging away for years, publicly, diplomatically and through its friends in Washington, on the dangers it fears from Iran. It pointed to three discrete threats: Iran's nuclear and missile programmes, its active support for the Hizbullah militants in Lebanon, and its steady output of ideological rhetoric denying Israel's legitimacy.

“The Americans never needed us for the facts,” a senior official recalls. “But we tried to keep Iran on their agenda.” Israel's dogged campaign can now, in the hardline post-September 11th atmosphere, be said to have helped prepare the way for America's tougher line.

Israeli intelligence experts do not believe that the Americans intend to make actual war on Iran. It is different with Iraq, where Israel rates the likelihood of a military attack much higher. This has resulted in a strict regimen of circumspect silence. Ministers, officials and army officers have been enjoined to desist from any public expression of encouragement or indeed desire for an American attack on Iraq. “The prime minister and those around him”, explains a senior official, “understand that if there is a strike and it doesn't go well, Israel could quickly become the target of a backlash in America.” In Europe and elsewhere, Israeli diplomats find themselves fending off uncomfortable accusations of vicarious jingoism.

Alongside the consonance of their broader views, Mr Bush and Mr Sharon seem to have achieved remarkable harmony regarding the Israeli-Palestinian conflict. With the deft timing of a seasoned player, Israel's prime minister pulled off a political and public-relations coup by secretly inviting three senior Palestinians, including Mahmoud Abbas (Abu Mazen) and Ahmed Korei (Abu Ala), to his home in Jerusalem on January 30th, leaking word of the meeting on February 1st. They spent three hours with the prime minister, discussing his ideas for an open-ended “interim agreement” to be signed while the Palestinians still control only half of the West Bank and Gaza.

They hastened back to report to Yasser Arafat, who remains incarcerated by Israel in his Ramallah headquarters. Both he and they assured the world that the meeting had been set up with Mr Arafat's prior approval and that it showed he was still in charge. Mr Sharon's aides insisted, with at least equal disingenuousness, that it demonstrated the opposite: the “irrelevant” Mr Arafat had been supplanted by “alternative and more moderate” Palestinians.

Mr Sharon's manoeuvre momentarily outflanked his restless Labour Party coalition partners. On the far

right, however, the settlers raged at his “surrender” and urged him “to learn from George Bush how to deal with terrorists.”

But Mr Sharon's surprise sally—this was his first such meeting with Palestinians since he took office exactly a year ago—probably sent a subtler signal to the Bush team than either his supporters or his traducers conceive. He was saying, in effect: You can get on with smashing the “evil axis” without worrying about the Israeli-Palestinian conflict. That is under control. Look, I'm even talking to them.

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South Africa's economy

Joy, confined

Feb 7th 2002 | CAPE TOWN
From The Economist print edition

Thabo Mbeki on the state of his nation

AS SOUTH AFRICA rehearsed the parades that go with the opening of parliament on February 8th, Thabo Mbeki prepared a sobering message for his countrymen. Even though a handy surplus from tax revenues means that there will be more money to spend on social services, the current growth rate of just over 2% a year exacerbates the difficulty of tackling the trickiest problems: crime, AIDS, and the too slow emergence of a black middle class. Above all, the sluggish growth rate provides little hope of a quick fall in the vertigo-inducing rate of unemployment.

Using a strict definition, about one in four South Africans is out of a job. If all the people who would like to work but cannot are counted, the rate is 37%. For black people, it is 43%. Since the African National Congress won office in 1994, many formal jobs have gone, and many informal ones have been created, but the jobless total has barely changed. No wonder that most people rank it their biggest problem.

Digging holes and filling them in

The government's Communist and trade-union allies are demanding public works to soak up some of the 7m jobless. Because it will mean the loss of jobs, they oppose the privatisation of telecoms, electricity, the airline and other state-run companies. But Mr Mbeki and his finance minister, Trevor Manuel, insist that employment will improve only when growth reaches 5%.

How to get there? The privatisation programme, reaffirmed this week, could help. There are plans for a “growth summit” at which businessmen and officials would plot faster expansion. And there are hopes of more foreign investment, following the lead given by carmakers such as BMW and DaimlerChrysler, whose exports and labour-intensive factories are doing well.

But the government could do a lot more itself, says Iraj Abedian, of Standard Bank, “We must create jobs that match the skills of the people available for work.” Land reform, for instance, would help and encourage small commercial farmers. Less regulation of industries would tempt investors. Or why not, he suggests, hire workers to clean up rundown urban areas, such as the centre of Johannesburg, to widen roads and improve basic amenities? “Not digging holes and filling them in, but building important infrastructure,” he explains. Several million jobless South Africans might well agree with him.

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Sudan's war

A ceasefire, but not yet peace

Feb 7th 2002
From The Economist print edition

Sudan's long-running war has paused, but peace is still distant

Get article background

DANCING, drumming, blowing cows' horns and roasting bulls, the people of the Nuba mountains, a black African enclave in central Sudan, celebrated the ceasefire. They are enjoying the first properly-monitored break in the shooting in this region for 19 years. Announced on January 23rd, it has held, touch wood, for two weeks. For a people who have long feared that their culture, with its music, wrestling and body-painting, would soon be wiped out, the ceasefire seems like a last-minute deliverance from oblivion. But it is only a first step on the road to peace in the rest of Sudan, a nation that has been at war, on and off, for almost half a century.

The war's longevity stems from the way religious and ethnic differences have been inflamed by politicians. The military government in Khartoum is dominated by Muslim Arabs from the north. The rebels of the Sudanese People's Liberation Army (SPLA) are largely black Christians and sky-god worshippers from the south. The SPLA says it wants democracy and secular government for the whole of Sudan, but is assumed by many to be aiming for southern secession. The government finds both options repellent, not least because there are large oil deposits in the south.

Into this maelstrom stepped an American senator, John Danforth, who was sent to Sudan as a special envoy last September, and has since moved fast. He announced that four conditions needed to be met before America could broker a lasting peace. Three have been met. The two sides have stopped fighting in the Nuba mountains. They recently maintained a nationwide ceasefire for long enough to allow children to be innoculated. And an investigation has started into reports that the war has allowed slavery to flourish (see article).

But the fourth condition has been flunked: President Omar Bashir insists that he cannot stop bombing the south. His excuse is that the SPLA continues to blow up oil pipelines. In the past couple of years, oil has become Sudan's main export, paying for much increased military spending and a boom in the capital, Khartoum, where luxury-car importers do a cracking trade.

Worn down by a decade of sanctions, Sudan is seeking removal from America's list of states that sponsor terrorism. Hence Mr Bashir's co-operation with American intelligence since September 11th, and his willingness to listen to Mr Danforth. But the regime is riven by factionalism, and the president may not be able to impose his will on his more hawkish subordinates.

Mr Danforth's formula for peace is “one country, two systems”: an Islamic government in the north, and a secular one in the south. The difficulty will be deciding how much autonomy the south is to be allowed. Southerners want a lot. The government has been dishonouring agreements with the south since the 1960s, and most southerners believe that self-determination is their best guarantee against future betrayals. On the other hand, the Americans will oppose anything that smacks of southern secession, largely because Egypt, an American ally, does not want multiple states controlling the Nile.

Time is not on Sudan's side. Mr Danforth's mission ends in March, and he has made it clear that he will go home. The SPLA's allies in America, mainly Christian fundamentalists who see the war as an assault by slave-trading Muslims on brother Christians, are lobbying for a Sudan Peace Bill, which would mandate aid to the SPLA and apply sanctions on oil firms that do business with the government. For now, Mr Danforth can use this bill as a stick to prod the government into making swift concessions. But if it becomes law, America will no longer be able to act as broker.

Other concerned outsiders could step in. Possible candidates include Clare Short, Britain's minister for overseas aid, or her Norwegian counterpart, Hilde Fraford Johnson. But the worry is that both sides may be content to go back to war. Mr Bashir's government uses the war as a reason not to hold elections. John Garang, the SPLA's leader, thinks that with southerners more united than for a decade, and with help from American Christians, he will be able to attack, and even capture, some oilfields. In the long term, however, neither side can win the war, and their people continue to lose from it.

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Slavery in Sudan

A funny way to end the slave trade

Feb 7th 2002 | ED DAEIN, SUDAN
From The Economist print edition

Charities who buy slaves their freedom may end up doing harm

Get article background

KNEELING on the prickly savannah, Bakhita Ahmed implores a stonyfaced Arab herder to release her brother. She and her sibling were both snatched and enslaved 11 years ago, when they were children. Recently freed, Bakhita wants to go home, to be with her people, the Dinka tribe of southern Sudan, even though she has been away long enough to forget their language and religion. She wants to take her sibling with her: “You have kept him long enough,” she says.

Sudan's government hotly denies that there is slavery. But in the past two years, a joint tribal committee of Arab and Dinka elders has quietly arranged the return of 670 children from captivity in the Arab north to their families in the country's black, southern half.

Slaves have long been seized during tribal clashes in Sudan. Traditionally, the numbers captured were relatively small, and many were returned to their families after the talks which ended each inter-tribal spat. But since the civil war reignited 19 years ago, such exchanges are rarer. The Dinka claim that 14,000 of their women and children have been kidnapped in the past decade. Most, like Bakhita, are renamed, obliged to become Muslims, and then forced to marry their captor or herd his animals. Eventually, they are accepted into his tribe as black—and therefore low caste—Arabs.

Christian Solidarity International (CSI), a Swiss charity, estimates that there may be more than 200,000 slaves in Sudan. This is surely an exaggeration. CSI's numbers are warped by the group's habit of buying slaves in order to set them free. The charity, and others, have “redeemed” more than 100,000 “slaves” in recent years, at $35-75 a head. This is a lot of money in Sudan.

Certainly it is incentive enough to prompt slavers to mount more raids, in order to capture more slaves to sell to CSI. But what aid workers think more likely is that many of the people being “redeemed” were never slaves in the first place. To con $35 out of a gullible westerner, many Sudanese would be happy to wear shackles for a few hours.

For real slaves, however, life remains wretched. The Arab herder tells Bakhita that he will free her brother. But not for another three months, or maybe more.

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Poland and the European Union

The angry farmers

Feb 7th 2002 | WARSAW AND BRUSSELS
From The Economist print edition

Relations between the European Union and the Central European countries negotiating to join it have taken a sharp turn for the worse

Get article background

THE 13 cows chewing placidly in the muddy stalls on Stanislaw Lempicki's farm look blissfully unaware of the trouble they are causing. But a row over the future of small farms like Mr Lempicki's, near the eastern Polish town of Ciechanowiec, is threatening the long heralded “reunification of Europe”—the process whereby the countries of the former Soviet block are meant to join their richer western neighbours in the embrace of the EU.

Eastern Poland has seen more than its share of suffering in the lifetime of 68-year-old Mr Lempicki. The site of the Nazis' former death camp of Treblinka is just down the road. Mr Lempicki's father, a Polish partisan, was shot by the Russians. But joining the EU was meant to be a symbol that the bad old days have been banished for ever, as Poland joins a club whose purpose is peace and prosperity.

Mr Lempicki and his fellow farmers are, however, starting to have doubts. Proposals for agricultural aid in an enlarged EU, published in Brussels last week, have caused a storm of protest in Poland, where they are being denounced as blatant discrimination against the EU's prospective new members. Mr Lempicki says he now has “more fears than hopes” about joining the EU. Radio Maria, a rabidly conservative Catholic station that he listens to, has long been castigating the Union and all its devilish works. The Peasants' Party, for which he votes, is angry too.

The focus of Central European discontent is the issue of “direct payments”—subsidies to farmers paid under the EU's byzantine common agricultural policy (CAP). Under last week's proposals, the newcomers would at first qualify only for 25% of the level of subsidy given to western farmers. True, this will rise to 100% of the western level in stages over the next ten years. But farmers like Mr Lempicki fear that in the intervening period they will be unable to compete with more heavily subsidised western exports and that many of them will be driven out of business.

Another threat comes from the imposition of EU production quotas. At present Mr Lempicki and his neighbours can produce as much milk as they can sell. In the EU, however, every dairy farm gets a milk-production quota. The EU's suggested quota for Poland, also made public last week, is far smaller than the one the Polish government had requested. So Polish farmers fear that they will end up having to produce less. They are not alone. The Hungarians, Czechs and Slovenes have also damned the proposals and all plan to co-ordinate a response later this month.

It may seem sad that so grand a historical venture—the reunification of Europe, no less—should be mired in sordid squabbling over milk quotas and subsidies. But, in truth, it was inevitable that the protracted negotiations over EU accession would come to a crunch over farming. These days the CAP may be reviled widely throughout the EU (except, perhaps, in France) as an unwieldy, protectionist monstrosity. Yet it gobbles up about half of all the EU's spending. Billions of euros a year are at stake. The issue is all the more crucial in Central Europe because so many people are involved in farming. A good fifth of Poland's population gain some part of their livelihood from the land—and will be deeply affected by the arcane proposals coming out of Brussels. In areas like eastern Poland, unemployment is already over 20% and the economy is slowing.

Add these economic concerns to Poles' age-old fear of exploitation by powerful neighbours, and the scope for a populist backlash is all too evident. Even before the farm proposals were published, the Poles already felt bruised by the EU's insistence on a transition period of up to seven years before they are allowed to work freely within an enlarged Union. “We want to join the EU”, says a leader of the local farmers' union near Ciechanowiec, “but not on our knees.”

Many Polish commentators fear that if the EU's agricultural offer is not improved, a referendum on Polish membership could be lost. Such worries, however, get little sympathy in Brussels these days. Günter Verheugen, the EU commissioner in charge of enlargement, fumed last week that Polish politicians had been “almost criminal” in dangling the prospect that their farmers would get immediate access to the full range of EU subsidies. Giving them direct payments on the scale they are demanding would, say the men in Brussels, not only cost countries already in the EU dear but would also warp local economies and prevent the sorely needed overhaul of Poland's farms.

Complaints of discrimination are met with a curt “bullshit” by an EU negotiator, who points out that the Poles have made plenty of requests of their own to delay the application of EU law in a variety of areas, from the environment to the sale of land. Moreover, a Polish agency that is meant to handle billions of euros in EU farm aid after the country joins the club is under investigation at home for mismanagement. In any event, Eurocrats point out that if the new members do manage to join the club by 2004, a net total of *euro*25 billion ($22 billion) in aid would pour into Central Europe between 2004 and 2006, about half of which would go to Poland.

Find a spinmeister, fast

Unfortunately the EU's presentation of its proposals has been dismal. Christopher Bobinski, editor of *Unia i Polska*, a newspaper, says that the EU has done so little to explain its case that “I sometimes wonder whether they don't half want the Poles to vote against membership, and get them off the hook.” A more prosaic explanation is that the EU's current members fear a backlash in their own countries against the perceived financial and social costs of enlargement, and assume that the Poles and others will just have to swallow their objections in pursuit of the bigger prize. As one EU man puts it, “I'm afraid that entering the EU is a fairly humiliating process.” In the end, the candidates have to lump it or leave it.

While the Poles hope that they and their fellow candidates can persuade the EU to improve its agricultural offer, it is just as likely that the current members will try to force the European Commission to be even less generous. The big contributors to the EU budget, in particular the Germans, are very worried that if they cannot secure a proper reform of the CAP, within a decade they will end up with a bill for the whole range of agricultural subsidies.

The real villain is the Common Agricultural Policy

Indeed, the real villain is not the meanness of countries already in the EU nor the prickly nationalism of the Poles but the CAP itself and the vested interests that have built up around it. Its huge cost and complexity and the array of perverse incentives and their bizarre consequences (farmers, for instance, being paid handsomely to grow nothing) make it virtually impossible to construct a plan for enlargement that does not seem either grossly unfair or horrifyingly expensive. An exasperated Jaroslav Kalinowski, Poland's agriculture minister and leader of the Peasants' Party, says that Poland does not want handouts, just equal treatment: “Why don't we just scrap all the subsidies, and compete on a level playing field.” If only.

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France and corruption

Bad news for the president

Feb 7th 2002 | PARIS
From The Economist print edition

Corruption scandals hurt France's president more than its prime minister

AP

Didier or didn't he?

WILL the dark cloud of corruption over French politics never be blown away? This week Didier Schuller, a former centre-right politician, returned to Paris after seven years in the Caribbean as a fugitive from justice. Depending on what—and how much—he reveals, Mr Schuller (pictured right), now in prison, could well determine the result of a presidential election whose first round is in just two months' time. Hence the alarm among the conservative supporters of President Jacques Chirac, and a disingenuous show of indifference among supporters of Lionel Jospin, the Socialist prime minister who is Mr Chirac's chief challenger.

The alarm on the right is surely well founded. Before his flight, first to the Bahamas and then to the Dominican Republic, Mr Schuller was a local councillor for Mr Chirac's Gaullist party, the Rally for the Republic (RPR), in the Hauts-de-Seine, a bourgeois district on the western edge of Paris. He also ran the district's public-housing department between 1986 and 1994, and so was well placed—according to the investigating judges—to siphon corporate bribes, paid in exchange for public-works contracts, into either the coffers of the RPR or his own pocket. There are allegations that millions of francs went into Swiss bank accounts, including one opened in his mother's name.

Perhaps the venality was personal, but Mr Schuller himself says that “the system the judges have been investigating since 1994 isn't that of local councillor Didier Schuller but of a party, the RPR.” Damning enough, especially since it appears to confirm the confession of Jean-Claude Méry, another RPR official, now dead. In a videotape released posthumously in September 2000, Méry described how the RPR and other parties, including the Socialist Party, had benefited from corporate kickbacks during Mr Chirac's tenure as mayor of Paris between 1977 and 1995. Indeed, at one point Méry described handing over FFr5m (then worth $720,000) in cash to an aide in Mr Chirac's presence. At the time Mr Chirac was not just mayor of Paris but also prime minister of France.

But he is not the only conservative luminary in the firing line. So, too, is Charles Pasqua, head of the ultra-Gaullist Rally for France party (RPF). It was Mr Pasqua, then minister of the interior, who allegedly told Mr Schuller to flee the country in February 1995. Mr Schuller's problems were not only allegations of corporate kickbacks but also his apparent attempt to discredit an investigating judge by giving a bribe to his father-in-law. This particular judge, Eric Halphen, last month resigned in frustration, saying his investigations into Mr Chirac and others had constantly been thwarted by political “sabotage”.

Even if that were true, how much would voters care? Until Mr Schuller's sudden reappearance, the right had convinced itself that “*les affaires*”, as the scandals dogging the president are conveniently termed, were irrelevant.

Watch it, Jacques

Various courts, from the Constitutional Council down, had ruled that an incumbent president cannot be forced to appear before any judge, even the persistent Mr Halphen. The resilience of the right in last year's local elections showed that voters had a forgiving streak. And the terrorist attacks on America on September 11th had given Mr Chirac the opportunity to rally the nation and appear presidential. Moreover, the public was getting bored by judicial investigations. Only this week, for example, after eight

years, did judges finish their inquiry into corruption involving the former state oil company, Elf. (Among the potential culprits they name Mr Pasqua.)

So it is possible that Mr Schuller's testimony may do little to change the mood. After all, he claims he has come back voluntarily (pre-empting an extradition request) “not to settle accounts but to render an account”, and with no wish to “harm the president of the republic”.

The trouble is, even the smallest change could lead to defeat for Mr Chirac and victory for Mr Jospin. For several months Mr Chirac has led the prime minister in the opinion polls. Now suddenly they are level-pegging for the first round of the election—and, when the lesser candidates are eliminated, no one is sure where their votes will go in a Chirac-Jospin run-off.

In other words, the right had better hit back with some pertinent questions before it is too late. Was Mr Schuller's son, Antoine, manipulated by a bizarre sect to denounce his father last week and reveal his luxurious whereabouts in the Dominican Republic? Is Mr Schuller's new lawyer a Socialist Party sympathiser? Has a deal been done, promising leniency for Mr Schuller and immunity for his mistress-in-exile, Christel Delaval? The answer, says an urbane former RPR prime minister, Alain Juppé, in a phrase whose vulgarity has raised many an eyebrow, is that the left “is stirring the shit.”

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Germany's cities

Empty coffers

Feb 7th 2002 | HANOVER
From The Economist print edition

Shrinking tax revenue has left German town halls short of cash

LIKE most German cities, Hanover has its share of proud civic symbols, from the statue outside the railway station of Ernst August, a 19th-century king of the local statelet, to the imposing, domed “new” town hall, completed in 1913. There are living treasures, too: Gerhard Schröder, the embattled chancellor, lives in the city, and its football team is heading for promotion.

Again like most German cities, Hanover also has deep financial problems. The cause is a collapse in revenue from the *Gewerbesteuer* (trade tax), a levy on company profits that is the cities' main source of tax income. Since 1999, says Herbert Schmalstieg, Hanover's mayor, the city's trade-tax income has fallen by one-third. Some other cities have fared much worse. “If losses carry on like this,” avers Mr Schmalstieg, “then in a few years German cities will be unrecognisable.”

Investment by municipalities has dropped by one-third, or *euro*10 billion ($8.7 billion), since 1992. Across the country there are stories of cuts in services, from the closure of a busy bridge in the Bavarian city of Würzburg to the shutting of playgrounds in Gelsenkirchen in the industrial west. Hanover too has a savings plan, its fourth since 1994, which should cut costs by *euro*125m, 8% of this year's spending, by 2004. Even so, says the city treasurer, this would reduce the basic deficit only by half.

The state of the German economy is one reason for the drying up of the trade tax. Lower profits mean less tax. In Frankfurt, for example, the city's finances are closely linked to the health of its big banks. In 2000, a bumper year, the trade tax yielded DM1 billion ($470m) more than expected. Last year, a poor one, revenue was DM500m below budget.

However, the cities' problems run deeper. Successive changes in the law have narrowed the tax base. Companies have been able to offset the costs of acquisitions, or losses made in a subsidiary in a different city or abroad, against their profits. Many companies, including a fair few of Germany's biggest, pay no trade tax at all. Having lost a recent court case, Hanover will have to pay a Berlin bank more than *euro*85m to refund tax collected from a local subsidiary since 1981. According to the local chamber of commerce, half the city's trade-tax revenue is paid by a mere 200 out of the 67,000 firms that are potentially liable; 36,000 pay nothing.

On top of this, the cities have been hurt by Mr Schröder's tax reforms. They have shared income-tax cuts with the federal government and the *Länder*, Germany's 16 states. The federal government has also upped its share of trade-tax revenues. The finance ministry had forecast that the reforms would increase the cities' income, so decided to take a bigger share in order to claw this back. As it happens, tax revenues have dropped, so the government is now scoffing a bigger slice of a smaller cake.

Despite its chronic deficit, Hanover still has ambitious plans, in the belief that investment will bring more prosperity to the city. In recent years it has built itself up as a centre for trade fairs and played host to the 2000 World's Fair. Now a new football stadium is going up and the Passerelle, an underground shopping street, is under renovation. “We must take care”, says the mayor, “that the current financial situation doesn't endanger the city's future development.” A tall order, not only in Hanover.

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Ukraine's general election

Kuchma's country

Feb 7th 2002 | KIEV
From The Economist print edition

A general election may shuffle the pack but do little to improve the country

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AP

New brooms needed elsewhere

SHE thought it was the ideal political marriage. He flinched. As Ukraine's general election next month approaches, the country's two most go-ahead politicians, by failing to strike a deal, make change look likely to be snail-like and patchy, if it happens at all. Ukraine is unlikely to become a much nicer place for its 50m people any time soon.

Viktor Yushchenko, a brawny, disorganised ex-prime minister much liked in the West for his talk of reform, is heading one way. Yulia Timoshenko, diminutive and steely, once his right-hand woman as deputy prime minister in charge of cleaning up Ukraine's murky energy industry, is going another. Mr Yushchenko reckons that by uncompromisingly opposing President Leonid Kuchma and his rich pals Mrs Timoshenko will flop. Instead, he has gone for a policy of milder opposition that may bring some crumbs of power.

So far, Mr Yushchenko has been proved right: he looks likely to get many more votes for his movement, Our Ukraine. He is wooing support not just in the country's independent-minded west but also in its economically beefier eastern part, inhabited mainly by politically docile Russian-speakers. On current form, Our Ukraine may even be the largest block in a new parliament. Though the president neither likes nor trusts Mr Yushchenko (and sacked him last year), he seems prepared to tolerate him and to use him when his foreign ties may be helpful. For instance, on a recent visit to the United States Mr Yushchenko personally handed a letter from Mr Kuchma to President George Bush's people in the White House.

By contrast, Mrs Timoshenko's outfit, Fatherland, is floundering, despite its hefty war chest; before she tried to clean up the energy industry as its minister, she had made pots of money out of it as a businesswoman herself. Her chances have been further damaged by a car crash which has kept her in hospital since last week.

Mr Kuchma seems more strongly entrenched than he was a year ago. Street protests about scandalous official behaviour, revealed by the taping of conversations in his office, have fizzled. Another corruption scandal that broke this week looks likely to do the same. The media rarely let the outspoken Mrs Timoshenko and her friends have a say. Moreover, many Ukrainians find her shrill denunciations of the president distasteful, even unpatriotic. She will be lucky to win even a handful of parliament's 450 seats.

Mr Kuchma's own block, For a United Ukraine, may well prove the strongest contender by polling day. Among its members are Vladimir Litvin, who runs the president's administration, in effect a parallel government, and Anatoly Kinakh, the prime minister. A founder of Mr Kuchma's group was Mykola Azarov, who heads Ukraine's tax service. Mr Kuchma's people have vast “administrative resources”—a post-communist euphemism for vote-rigging powers.

The other big election weapon is compromising material (*kompromat*, for short). Mr Yushchenko is under fire in the kind-to-Kuchma press for his ties to a bust bank where he once worked. It may have benefited from lenient treatment when he ran the central bank. Some of the attacks come from websites with strong Russian connections. Another scandal involves Ukraine's dodgy arms-trading led by some of the president's friends. Mrs Timoshenko has already spent time in jail on corruption charges that had a strong whiff of politics about them.

The biggest recent news, though, is a struggle for power among the country's top tycoon-politicians. One big clan took a surprising knock late last year when its chief, Viktor Medvedchuk, was ousted as parliament's deputy speaker. A potential presidential candidate with many Russian connections, he has a lot of friends among the country's ill-paid and flexible judges and prosecutors. But it seems that Mr Kuchma thought he was getting above himself. His party, the Social Democrats, is likely to do badly in the election.

Amid all this hubbub, life for most Ukrainians is becoming a bit less drab. Real wages, though still miserably low, rose 20% last year. The economy grew by a perky 8% (more than Russia managed), though growth is now tailing off. Inflation, over 10,000% eight years ago, has dropped to an annual rate of just 6%. Until everything stopped for the election campaign, new laws were whizzing through parliament, and the government was functioning smoothly under the efficient Mr Kinakh. As with Russia, Ukraine's former imperial master, outsiders are pleased and surprised that things are going so well, while worrying that the new laws will have little practical effect and that change will become bogged down without deeper reforms—for example, in the puny and corrupt banking system.

The central question is what Mr Kuchma and his presidential court will do if, as seems likely, the new parliament proves even more pliant than the present one. Probably, they will simply hang on to power. That will disappoint the West, which would like Ukraine to be a less seedy neighbour to the European Union when some of the countries in between, including Poland and Hungary, join the western club in the next few years.

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Spanish drivers

Please slow down

Feb 7th 2002 | MADRID
From The Economist print edition

Will new rules make Spanish drivers less dangerous?

EVERY Monday, Iñaki Gabilondo, a popular Spanish broadcaster, tells his listeners how many people have been killed in car crashes over the weekend. The usual toll is between 30 and 40. That puts Spaniards among the worst drivers in the EU, though they are not quite as bad as the Portuguese or Greeks. (Standards in the ex-communist countries—see chart—are of another order of recklessness.) Swedes and Britons are nearly three times safer, per 1m vehicles on the road, Germans twice as steady. So the Spanish government, ashamed of its drivers' performance, has brought in tougher new rules for them.

If a Spaniard now commits a serious offence, like speeding at more than 50% over the limit or driving under the influence of drugs or alcohol, he can lose his licence for three months, as well as be fined up to *euro*602 ($519) for each of those offences. If he commits three such offences within two years, he may be banned for life. Such penalties are quite usual (and sometimes harsher) elsewhere in the EU; in Spain they are considered draconian.

Some are more careful than others
Accidents on the roads, 1998

	Annual deaths	Deaths per 1m vehicles	Deaths per 1m people
Albania	308	2,184	92
Russia	29,021	1,286	198
Greece	2,226	679	212
Poland	7,080	672	183
Portugal	2,126	350	224
Spain	**5,957**	**314**	**151**
Belgium	1,500	300	147
France	8,918	276	151
Austria	963	229	119
Denmark	499	228	94
EU	41,907	206	156
Italy	6,267	180	110
Germany	7,792	176	95
Netherlands	1,066	151	68
Britain	3,421	125	58
Sweden	531	123	60

Source: European Conference of Ministers of Transport

Will they work? At present the police often turn a blind eye when Spaniards break the rules. Drivers travelling at up to 30kph above the 120kph (75mph) speed limit on motorways generally get away with it. A drink or two at a roadside café has never been considered wrong. Driving while chatting on a mobile phone is common, though specifically forbidden by the new rules.

This time, insist the traffic authorities, they will strictly enforce the rules. But one listener to Mr Gabilondo's programme struck a chord when he rang up to complain. “Why are glamorous sports cars on sale,” he asked, “if we can't drive them faster than a miserable 120kph?”

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Charlemagne

Europe's crowned heads

Feb 7th 2002
From The Economist print edition

They just won't fold up their beds and slip away

IN THIS 21st century, the idea of monarchy should be dead, you may think (and this paper does). But Europe's royals have recently proved themselves alive and kicking, even if at times they kick each other. And though Europe's citizens are split on the issue, where royalty is alive not many people want to scrap it.

This month has offered a striking example of royal ability to win public hearts—and one of the reverse. The wedding of the Netherlands' crown prince was a triumph. The ever-virtuous Dutch did not fancy the bride's father, 25 years ago a minister in Argentina's military junta. Even after they learned that his job had been to deal with farming, not political prisoners, they insisted he must stay away. But who can resist a lovely about-to-be princess, nay, one who has taken care to learn the language and visit every province in the land? The day was crowned by a long kiss suggesting to romantic onlookers that royals can be as happy as anyone with the people they ought to be happy with.

Meanwhile, Denmark's Prince Henrik, husband of Queen Margrethe, was suggesting no such thing. He did not accompany his wife to the Dutch wedding; from their chateau in southern France, he had opened his heart to a Danish newspaper, to tell it just how he felt being no longer even number two in the royal family but (after his eldest son, the crown prince) number three. A French diplomat before his marriage in 1967, he plainly had had enough of twiddling his thumbs. Who wouldn't? But royals are paid not to say such things out loud. “He'll be home in a week,” chirped a palace official; the royal family's “gravest crisis yet”, wrote *Politiken*, Denmark's weightiest daily.

Imagine what Britain's nothing-is-sacred tabloids would have made of such a tale. Not that you need imagine: they do it constantly, and not just the tabloids either. Princes Philip, Charles, Andrew, Edward, William and Harry, Queen Elizabeth (50 years in the job this week), the late Princess Di, the very present if off-screen and not quite royal Camilla Parker Bowles, —you name him or her, and Fleet Street has something nasty to drag up and worse to concoct. Yet to what effect? Here is the paradox of Britain's love-sneer relationship with its royals.

In all our majesty, we the people have decided that the Windsors are the most dysfunctional family around. A century ago, the British, barely out of the straight-laced Victorian age, rejoiced in their King Edward VII, a man famed for little but his skill at killing game birds and being happy with any man's wife but his own. In contrast, the present generation of Britons, which presumably has never committed adultery, divorce, bad parenting, tree-hugging, overspending or even the odd drag at a joint, delights to sit in judgment on the royals who have. For years, it was widely agreed that Britain's heir to the throne could not decently marry his mistress (“doing the decent thing”, it used to be called, but times have changed). Even now, according to an opinion poll published this week, one-third of Britons still think that way, and—should Prince Charles dare to disobey—four-fifths of them would not want Camilla named queen. So abolish the monarchy itself? No. Only one Briton in five told the pollsters they agreed with that.

Norway saw a similar story last year, when its crown prince chose as his bride a single mother with a child by a convicted drug-user. Some eyebrows were raised and influential voices lifted to ask why have a royal family if it behaves just like any other family. But that was all; the marriage went ahead, and only a quarter of Norwegians tell pollsters they want a republic.

Crown princes and their ladies are apt to be trouble. Two months ago, Spain's Prince Felipe broke off a relationship. The lady concerned was respectable enough, but in Spanish eyes no future queen: a Norwegian speaking little Spanish, a commoner and a model, no less, who, in honest pursuit of her

profession, had been photographed—oh, the shame of it—in her underwear. The break was by mutual consent, officially. But the prospect of a marriage had aroused criticism rare in a country whose media are habitually respectful of its ruling family. This clearly played a part in the story. Outsiders could wonder why. When King Juan Carlos came to the throne in 1975, after Franco's death, he proved not just ready to live with democracy but its stout champion when some military ninnies in 1981 tried to kill it again. Monarchy cannot be taken for granted in Spain, more than once a republic; but was it so ill-rooted that one less-than-queenly foreigner could threaten it? Some Spaniards thought so.

Goodbye—and yes, we mean it. Some of us

And how easily do countries that have kissed their monarchies goodbye live without them. The Italians did so in 1946, for all the services of the house of Savoy to Italian unity 85 years before. Only this week did their senate vote to let male members of the dynasty even set foot in Italy again. France's rival clans of monarchists are a joke in a country where “republican” is an adjective of honour. United Germany's monarchy lasted less than 50 years from its invention in 1871 to its abolition after the first world war; and Germans in 1945 did not think of reinventing it.

Yet dynasts can still charm republics, including ex-communist ones. Last year, Bulgarians elected a government led by their ex-king, and Romanians and Yugoslavs cheered royal claimants when they came on visits. Most of Europe's monarchs, with or without thrones, can at least claim to be in tune with the music of European integration. For centuries royals have married across frontiers like rabbits, and can now bask in their Europeanness. Witness the learned (and amiably crownless) Otto von Habsburg, for long a Bavarian Euro-MP, whose younger son, Georg, has been an ambassador for Hungary, while his heir, Karl, has served as a Euro-MP for Austria.

Europe's surviving monarchies may be inherently anachronistic. How striking, then, that most look pretty secure—not least among the egalitarian Scandinavians and Dutch.

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Britain and the euro

Fit to join?

Feb 7th 2002
From The Economist print edition

A row over Gordon Brown's budget plans shows how difficult it will be for Britain to squeeze into Europe's fiscal straitjacket in order to join the euro

Get article background

JUST as public opinion is apparently warming to the idea of joining the euro, relations between Gordon Brown and the European Commission have soured. The cause of the dispute is a ticking-off from Brussels about the chancellor's fiscal plans. This is no ordinary disagreement. It goes to the heart of whether Britain can both join the euro and maintain the drive to improve public services.

At first sight, the row between Mr Brown and the commission looks more theatrical than real. The commission says that Britain is failing to meet the rules of the stability pact by planning to run a budget deficit. This runs counter to the pact's stipulation that member states—both in and out of the euro area—should keep their budgets “close to balance or surplus over the medium term”. For the moment, that does not much matter, since fines can be levied only on euro members.

But if Britain were to join the euro, say in 2004, the stability pact would become highly relevant. Up till now the main focus of debate on whether Britain could make a success of euro membership has been about monetary policy. The principal question that the chancellor's five tests seek to answer is whether Britain could live with interest rates set by the European Central Bank. Underlying this is the worry that the British economy differs so much from the rest of the European Union (EU)—for example, through a housing market especially responsive to changes in interest rates—that a one-size-fits-all monetary policy will prove harmful.

The latest row, however, highlights a different question—whether a one-size-fits-all fiscal policy set in Brussels will prove damaging. One criticism of the pact is that it makes little sense for countries to limit their fiscal freedom now that they have surrendered control over interest rates and exchange rates within the euro area. That applies to any euro member state. But there are two particular reasons why Europe's stability pact could prove especially problematic for Britain.

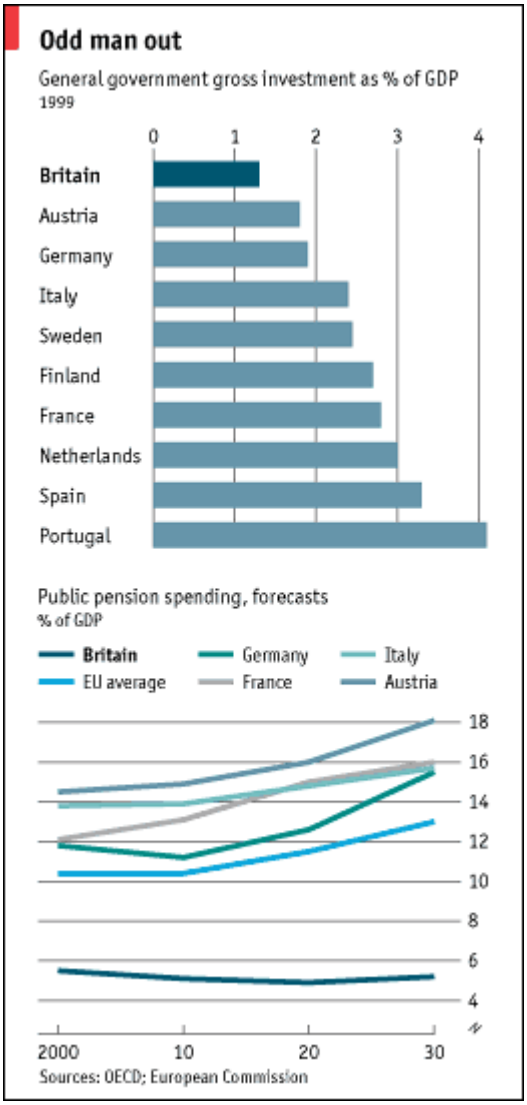
The first is that Britain's public infrastructure is exceptionally run-down compared with the rest of Europe. Government investment is much lower as a proportion of GDP than in most European countries (see chart). After a long period of neglect, culminating in Labour's first term of office, there is an urgent need to remedy matters. That is why Mr Brown plans to double net public investment's share of GDP to 1.7% by 2003-04 and then to sustain this level of spending. He wants to finance most of the investment by borrowing, arguing that this is fairer than funding through taxation since it spreads the cost of works that will benefit people for many years to come. With debt now very low in relation to GDP, he maintains that borrowing to invest is also fiscally responsible.

But the European Commission is anxious to ensure that the EU

as a whole reduces debt in relation to GDP by running balanced budgets or surpluses. A particular reason for this is concern about the future impact of Europe's ageing populations. This will lead to big increases in spending on pensions and health, resulting in likely deficits and higher debt. This could in turn undermine monetary union as the more heavily indebted countries lobby for inflationary policies to erode their debts. Hence the need to use the next ten or so years, before population ageing gathers momentum, to lower the public debt burden.

That policy may be legitimate for the EU as a whole, but not for Britain. This is the second way in which a one-size-fits-all fiscal policy creates a particular problem because of British exceptionalism. For one thing, Britain's debt is the third lowest in the EU as a share of GDP. More important, Britain does not face the same pressures to raise public pensions as other European countries, partly because population ageing will be less intense but also because big private schemes bear much more of the strain of pension provision, and they, unlike state pensions, are funded. Worries about the adequacy of pensions have led the British government to boost poorer pensioners' income, but this will not change the broad picture.

Over the next few years, then, there is a mismatch between Britain's need for higher investment and the euro area's need for lower debt. One way round this would be to interpret the stability pact more flexibly to meet the interests of individual member states. Treasury sources say that the commission has no monopoly of wisdom in interpreting the pact and criticise the commission for a narrow, legalistic approach. The chancellor will press Britain's case at the next meeting of finance ministers on February 12th, arguing that his budgetary projections are consistent with a prudent interpretation of the stability pact. The commission does not want a confrontation but fears that allowing one exception will open the door to special pleading by other countries.



If the stability pact were to become binding—as early membership of the euro would entail—then this will create real problems for Mr Brown as he tries to find the money to pay for improvements in the public services. He has already been preparing the ground for tax increases in this year's budget. But these would have to be a lot bigger—possibly as much as £10 billion—for Britain to comply with the pact.

Tony Blair wants Britain to join the euro. He also wants to rebuild the public services without upsetting taxpayers. Those two aims may be incompatible.

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Land reform in Scotland

Mcgabe

Feb 7th 2002 | EDINBURGH
From The Economist print edition

A bill going through the Scottish Parliament threatens Highland landowners

ROBERT MUGABE may never have been to the Scottish Highlands, but he is much talked of in the glens these days. The Highland air is thick with claims of expropriation, for a bill is going through the Scottish Parliament to give landless locals a subsidised chance to get their hands on chunks of big estates.

Battleground

According to the Scottish Landowners Federation, 0.08% of the population own 80% of Scotland. This concentration of ownership is at its most acute in the Highlands. Andy Wightman, a land reform researcher, says that 90% of Inverness-shire is in the hands of 138 owners; 90% of Sutherland is controlled by 58 owners. In western Europe, he says, land ownership is, on average, about 100 times less concentrated and, for instance in parts of Scandinavia, communal ownership is common.

The Scottish government wants to encourage more communal ownership and to put an end to the vestiges of feudalism. To this end, it is pushing a bill through Parliament which would allow 11,500 crofters—a type of small-holding part-time farmer peculiar to the Highlands and Islands—the right to buy the fishing rights to salmon rivers running alongside crofts, whether the landlord likes it or not. Since fishing rights are often the most valuable bit of the land, this is causing grief.

What's more, the government will subsidise the purchase, through National Lottery funds. The residents of Gigha benefited from this, when they bought their island from a (willing) owner last year. The lottery stumped up £3.5m ($4.9m); the residents £250. They now have to repay some of the government cash.

James Hunter, the mild-mannered chairman of Highlands and Islands Enterprise, an economic development agency, has been the subject of demonstrations accusing him of Mugabe-style tactics. He says the law is about encouraging enterprise and self-reliance. He cites the island of Eigg, which endured a succession of bad landlords until the 70 islanders bought it for £1.6m in 1997. Maggie Fyffe, secretary of the Eigg Trust, says that the unemployment and welfare dependency that characterised the island's economy before the buy-out has virtually disappeared.

But Eigg lacked investment. Most Highland estates do not—or did not. David Cotton, who manages a 50,000-acre estate plus salmon river in Sutherland, says that around £2.5m-worth of planned investment in rivers has not happened this year because of the threat of compulsory purchase. Rivers are expensive toys: banks have to be maintained, hatcheries built, poachers warded off. Rich people will pay to maintain rivers, but not if they fear losing their land. “Vast areas of the Highlands are dependent on the goodwill of very rich people who, in the main, are remarkably generous because they have a strong relationship with the people who work for them,” says Mr Cotton.

Mr Cotton is a spokesman for the 450-500 ghillies, water bailiffs and hatchery workers employed full-time on estates, plus 650 or so seasonal workers employed on Highland rivers. They fear that a bill

intended to help the people of the Highlands may end up doing the opposite.

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Harrods

Chairman Mo's red ink

Feb 7th 2002
From The Economist print edition

Trouble in store

Reuters

EVEN though he has misrepresented his wealth, offered brown envelopes stuffed with cash to MPs and falsely accused a former colleague of criminal corruption, Mohamed Al Fayed, the chairman of Harrods, London's premier luxury store, was not beyond the pale for the world's largest accountancy firm. Now, without explaining why, PricewaterhouseCoopers (PWC) has resigned as auditors to Harrods, which the Al Fayed family owns through offshore companies.

PWC's resignation, which became public last week, was abrupt. Last November the firm gave Harrods' latest accounts a clean bill of health and told Mr Al Fayed that it was willing to continue as the group's auditors. Seven weeks later the firm had resigned. PWC won't give its reasons, but says that there is nothing connected with its resignation that it considers should be brought to the attention of the group's creditors; so why it should have suddenly dumped Harrods, which paid it fees of £700,000 last year, is a mystery.

This is one of a series of recent blows to Harrods. Shortly before Christmas the store's managing director, who had been in his job for seven months, left and a Conservative MP resigned from the board to “pursue other business interests”.

Mr Al Fayed is said to be planning to list Harrods on the stockmarket in America this year. PWC's resignation is hardly likely to reassure potential investors. Nor are the latest published results of the group, whose businesses include tax-free concessions at British airports, a shoe retailer, a heliport and an estate agency in addition to the department store. It made an operating profit of £29m on sales of £540m in the year to last January. This compares with £55m on similar turnover three years earlier. Profits after interest and tax were a meagre £3m.

The directors' explanation for this performance was as unimpressive as the figures themselves. They said that the group faced difficult trading conditions in the year to January 2001 “due to external factors such as the foot-and-mouth epidemic”. The foot-and-mouth epidemic started in February 2001.

The Harrods group has also hocked the store to its bankers. By January 2001 its net debts were £316m compared with £91m six years earlier. Part of this increase is attributable to dividends taken out by the Al Fayed family in this period—£134m in total. A further dividend of £40m was paid out last October, two months after the group sold one of its many valuable properties for £53m.

Another of Mr Al Fayed's assets, the Ritz Hotel in Paris, also has a dismal record—it has made a profit in only one of the last six years. According to its latest accounts, which were audited by KPMG, another accounting giant, the company obtained a new *euro*141m (£86.6m) loan facility last May. This loan is secured on the hotel and Mr Al Fayed's shares in the company, which are held through companies registered in Jersey and Luxembourg. As well as repaying existing bank debt, the new loan appears to have been used to refinance a FFr405m loan from the Jersey company.

Mr Al Fayed has numerous offshore companies, none of which is obliged to publish any financial information. But a clue as to how he may have used his dividends from Harrods lies in two of his British businesses. These are Liberty Publishing & Media, which owns *Punch*, a weekly magazine, and Fulham, a football club in west London. Mr Al Fayed has poured tens of millions of pounds into these businesses

from offshore companies in the British Virgin Islands and Jersey.

Mr Al Fayed's moribund Liberty group has chalked up losses of £23m since 1996. It sold its radio station, Liberty Radio, 18 months ago, leaving *Punch* as the group's only business. Liberty's latest accounts show the magazine's sales revenue was a paltry £282,000 and that it made an operating loss of £2.2m.

Since Mr Al Fayed bought Fulham in 1997, the club has been promoted to the Premier League from the second division of the Nationwide League—at a massive cost. According to Deloitte & Touche, an accountancy firm, Fulham made the second largest operating loss (£10.4m) of any of England's 92 professional football clubs in the 1999-2000 season. Since then the club has spent around £40m on buying players. *The Economist* estimates that Mr Al Fayed has injected around £80m in total into the club, where he is known as Chairman Mo.

Most Premier League clubs lose money, so Mr Al Fayed is likely to have to keep putting his hand in his pocket. In addition, Fulham recently obtained the go-ahead to redevelop its ground to construct a swanky all-seater stadium, which the club estimates will cost £70m. Fulham's fans will be hoping that trading at Harrods has picked up.

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David Blunkett

Subtle reformer

Feb 7th 2002
From The Economist print edition

A man with vision

The home secretary is doing some difficult and admirable things

MAYBE David Blunkett has views that don't fit easily into a single box, or maybe he is a master tactician. Either way, the home secretary has done something exceedingly clever: he has persuaded the law-and-order lobby that he is an authoritarian while acting like a radical liberal in the three most difficult areas that he is responsible for—prisons, immigration and drugs. These are all areas where existing policies are not working, but where previous home secretaries have shied away from the political difficulty of trying anything new.

• **Prisons**. Britain's prison population has been rising for a decade, and is now higher, as a proportion of the population, than in any other western European country except Portugal. Britain's jails are dangerously overcrowded and the Prison Service is getting desperate.

Stricter sentencing policy is the main reason. People are being locked up more, and for longer periods of time, than they were ten years ago. That is why, although crime is falling, there is no sign of the rise in the prison population being reversed. Competition between Labour and the Tories to sound tougher-than-thou has encouraged successive home secretaries to push for longer and longer sentences.

In a speech on February 4th, Mr Blunkett announced what the Home Office described as “the start of the most fundamental rethink of the prison system since the 19th century”. He wants a “third way” of options, between community service and a full custodial sentence. This would include, for instance, sentences which would allow prisoners to keep a job but spend evenings and weekends in prison; secure hostels, or very open prisons, part of whose job would be to cater to the large number of offenders who are mentally disturbed and have difficulty dealing with real life; community service orders under heavy supervision.

• **Immigration and asylum**. The debate had got stuck on the idea that foreigners are a bad thing, with Conservative and Labour battling to appear more determined to keep them out. Mr Blunkett wants to encourage immigration by the sorts of skilled people that the economy needs.

The most prominent scheme is the Highly Skilled Migrant Programme (HSMP), which started on January 28th. This aims to attract only well-qualified workers, who might not have a prior offer of employment. A typical applicant under this scheme would have at least five years' experience in a graduate-level job, earning (if he lived in the EU) at least £40,000 a year. The skilled migrant can stay for an initial period of four years, and then apply for permanent residence.

Mr Blunkett's White Paper on nationality, immigration and asylum policy, unveiled on February 7th, contained plenty of fodder for those concerned about floods of foreigners, such as citizenship and language tests for people wanting to become British, and a crackdown on “bogus marriages”, making foreigners in Britain wait for two years to prove that their relationship is genuine. But the White Paper also included measures to speed up the asylum process and to build new induction centres for applicants.

• **Drugs**. Britain has the worst drug problem of any western European country, and it's getting worse. While the numbers dying from heroin, for instance, are stable or falling elsewhere in Europe, in Britain they have risen sharply over a decade. At the same time, there is widespread use of soft drugs and contempt for the laws that criminalise them.

The police are as fed up with enforcing unenforceable drugs laws as the prison officers are with managing unmanageable prison numbers. Encouraged by them, Mr Blunkett has introduced an experimental scheme to permit the use of cannabis. Dealing is still a crime, but people can no longer be arrested for smoking the stuff or carrying enough for their own consumption. And Mr Blunkett is also supporting changes in the rules which will allow doctors to prescribe heroin to addicts. The success of a scheme in Switzerland suggests that, for some addicts, that may be the best way of dealing with the problem.

There is, of course, still plenty for liberals to worry about. On February 5th Mr Blunkett unveiled proposals for new “entitlement cards”: ID cards in all but name. He defended these as a necessary step to combat social-security fraud, and argued that people would not be forced to carry them. The civil rights lobby protested anyway.

But where were the usual protests at his other, dangerously liberal, proposals? Nowhere to be heard. The Tories' home affairs spokesman, Oliver Letwin, is himself a sensible, thoughtful liberal who must approve of Mr Blunkett's agenda. And Mr Blunkett's authoritarian side long ago forged a close relationship with the *Daily Mail*, the voice of Middle England, which is now proving very useful.

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London Underground

A person on the line

Feb 7th 2002
From The Economist print edition

The government is going ahead with its scheme for the tube, despite fierce criticism from Parliament and almost everybody else

WHATEVER the failings of Stephen Byers, the transport secretary, he certainly isn't a wimp. Having ignored a lengthy campaign on the part of the City for compensation for Railtrack shareholders and faced down a vitriolic press campaign for his resignation, he has also dismissed a damning report by a House of Commons committee on the proposed public-private partnership (PPP) for the London Underground, published on February 5th, by deciding to proceed with the hugely controversial scheme after the publication of the committee's findings.

The PPP saga is now in its fourth year and shows no sign of reaching a happy conclusion, either for Londoners in need of a better Tube system, or for the government, which stands alone as a wholehearted supporter of the scheme. The ferocity of the committee's attack reflects the depth of opposition to the PPP. In the words of its chairwoman, Gwynneth Dunwoody, “it was difficult for us to find anything good in this deal”. The report criticised every aspect of the scheme, arguing it was expensive, possibly unsafe, did not transfer sufficient risk to the private sector and delivered few benefits, particularly in the early stages of the 30-year contract.

The PPP was conceived after the 1997 election as a compromise between John Prescott, the former transport secretary, who managed to ensure that the Tube was not privatised, and the chancellor, Gordon Brown, who refused to carry the full burden within the public sector. The PPP would split London Underground into four—an operator, which would remain in the public sector, and three private-sector infrastructure companies, which would maintain the network. To many of its critics, this sounds too close to the way the railways work (or don't) for comfort.

Ken Livingstone, the mayor of London, who will have responsibility for running the Tube, continues to battle against the PPP's imposition. Bob Kiley, his transport supremo, rejected it as unworkable after a lengthy negotiation last year involving close to 100 meetings. Almost everybody who has looked at the scheme has poured scorn on it, largely because of its complexity. Contracts include 3,000 performance goals in a 2,800-page manual. The algebraic formulae required to measure performance, representing such obscure factors as the average size of litter items, have been widely lampooned.

The Commons committee was most angered by the fact that the Treasury declined to send anyone along to face a grilling by the MPs. Quite apart from the contempt this shows for Parliament, it demonstrates once more the Treasury's reluctance to defend a scheme for which it is largely responsible. Last year, Mr Brown refused to answer questions on the PPP at a private meeting of Labour MPs, saying that it had nothing to do with the Treasury. Yet it was a Treasury mandarin, Sir Steve Robson, who dreamt the whole thing up in the first place, and two secondees working for the Treasury, Adrian Montague and Shriti Vadera, who led last year's protracted negotiations with Mr Kiley.

Indeed, the PPP is being driven by two Treasury imperatives: the need to get the massive investment needed for the Tube, some £750m per year, off the government's balance sheet and its reluctance to allow the public sector to do its own procurement on major schemes. Opponents of the PPP question both aims. The first, they say, has led to damaging under-investment; the second raises the question of why, if the public sector is so bad at procurement, it is being allowed to specify the contracts for a revolutionary 30-year investment programme.

None of this seems to trouble Mr Byers. He is confident that endorsement from an Ernst & Young report on value for money will be sufficient to protect him from any subsequent flak. This may prove to be a mistake. While the bodies on the track of which Mr Livingstone warns darkly will probably not materialise,

Londoners will forever blame the shortcomings of the Tube on Mr Byers and Mr Brown—and on their boss, Tony Blair, who privately wishes the whole mad scheme could be quietly buried.

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Culture wars

Ivan Agonistes

Feb 7th 2002
From The Economist print edition

Was it a row, or was it performance art?

BRITISH culture has a pantheon of visionaries who suffered for their art, only to be vindicated by history: think, for instance, of D.H. Lawrence and the Chatterley scandal. Last week, British art acquired its latest martyr. His offence, though, was not to champion novelty against traditionalism, but vice versa.

Ivan Massow, a successful businessman, brought ruin upon his head by writing in a magazine that much conceptual art—the school that dominates Britain's trendiest galleries—is “pretentious, self-indulgent, craftless tat”. He reserved especial opprobrium for Tracy Emin (best known for making an exhibition of an unmade bed), who, Mr Massow wrote, “couldn't think her way out of a paper bag”. The current hegemony of conceptual art, he argued, is akin to that of socialist realism in the Soviet Union; like the dotcom bubble, it is founded on a confidence trick.

These are widely held views. But Mr Massow was, at the time he expressed them, chairman of the Institute of Contemporary Arts (ICA), which is dedicated to promoting all that is new-fangled, contemporary even, in the cultural world. After a week of over-hyped wrangling, he was obliged to resign—protesting that this summary justice only proved his point.

There are two ways to interpret this contretemps. One is that Mr Massow made a noble stand against a sinister cult, whose claim to value ideas above artistic execution is merely a sophistic cover for an absence of talent. The mullahs of this cult are Charles Saatchi, a millionaire art collector; and Sir Nicholas Serota, the presiding genius of Tate Modern, whose critics argue that it is more circus than gallery. These days, so the argument goes, the object of most artists (apart from money) is controversy; prizes are awarded for headline-making rather than accomplishment.

Others have expressed this view even more stridently. Last year's Turner prize show—won by an installation consisting of a room in which the lights intermittently turned off, and then on again—was picketed by sceptics flashing torches. Other recent heirs to the critic who famously took Marcel Duchamp's urinal at face value include the purists who jumped on Ms Emin's bed, and the cleaner who mistook an installation by Damien Hirst for a pile of rubbish, and threw it away.

But there is another interpretation. In the world of contemporary art, there is no such thing as bad publicity. Mr Massow himself is a serial controversialist, who sensationally resigned from the Conservative Party over its attitude to homosexuals. He, the ICA, and Ms Emin have all emerged from this spat with even greater notoriety. One of the problems with modern art is that it is very difficult to tell where the art ends and real life begins.

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Bagehot

The loneliness of Tony Blair

Feb 7th 2002
From The Economist print edition

Where have all those chums gone?

EVEN by the forgiving standards of Tony Blair, the resurrection of Peter Mandelson, the close friend whom the prime minister had to remove from his cabinet twice in the government's first term, would require a miracle. Perhaps, unnoticed, one has occurred. Why else should Mr Blair have agreed to have Sir Anthony Hammond review new evidence which Mr Mandelson claims to have found since Sir Anthony's inquiry last year into his role in securing a British passport for an Indian businessman? Mr Mandelson has pointed out vehemently time and again that the Hammond inquiry—which reported after his sacking—cleared him of any wrongdoing. So the new evidence cannot exactly clear Mr Mandelson's name. But it may, in light of the aforesaid miracle, clear his way back into high office.

The miracle is this. Whether you look at his position at home or abroad, Mr Blair—that gregarious forger of coalitions, pitcher of “big tents”, “pivotal” statesman, navigator of third ways and builder of transatlantic bridges—appears suddenly alone. He has fallen out, or is in danger of falling out, with George Bush. Because of this, he is no longer being fawned over in quite the same way by his fair-weather friends in mainland Europe. At home, he has antagonised the trade unions, partly by accident. And his cabinet, though not yet entirely dysfunctional, hardly abounds with sympathetic faces.

Just a few weeks ago, Mr Blair was the belle of the anti-terrorism ball, the European leader so close to Mr Bush that the other presidents and prime ministers of Europe beat a path to Downing Street to be briefed on what America was *really* thinking. Being in with Dubya made Mr Blair a disproportionately honoured guest in Jerusalem, Gaza, Delhi, Riyadh, Islamabad—you name it. But this particular party is now over. One thing that has ended it is the changing mood in Britain. Voters—or, at least, the editorialists who claim to speak for voters—say that it is time for Mr Blair to stay home a while and concentrate on his day job. With the Tories poking fun at his “designer diplomacy”, Mr Blair cannot afford to risk many more worthy but nonetheless foreign diversions such as this week's whirl through Africa.

The changing mood in Britain is, however, only one of Mr Blair's problems. Another is that his dalliance with Mr Bush, the very thing that was yesterday making the British prime minister into such a social success, is now looking like a liability. Matters were bad enough when the Americans slapped down the handful of British politicians who had dared to criticise America's treatment of the British and other prisoners at Camp X-Ray. They got abruptly worse after Mr Bush's denunciation of the Iran-Iraq-North Korean “axis of evil” in last week's state-of-the-union speech. Jack Straw, Britain's foreign secretary, said unwisely in Washington that the president's words should be discounted as a bit of domestic electioneering. But even without Mr Straw's *faux pas*, the “axis of evil” puts Mr Blair in a pickle.

Britain's prime minister may feel himself in the position of Jane Eyre's Mr Rochester when he discovers the awful truth about the lovely Caribbean bride he has brought home in triumph to Thornfield Hall. Whatever the objective merits of Mr Bush's worldview, that speech has confirmed the prejudice of many condescending Brits that the American president, if not barking mad, is at least a dangerous simpleton. What is worse, Mr Blair has no obvious way out of this dilemma. He had always implied that the quid Britain receives for the quo of supporting Mr Bush is a respectful hearing in Washington. Now this bluff is being called. Would Mr Blair support American pre-emptive wars in the Middle East and Asia? Can he talk Mr Bush into moderating his policy, or even his language? Mr Blair's European partners can be forgiven a certain wry amusement as they watch Mr Blair struggle to prove how “pivotal” Britain really is.

A blizzard of mixed and muddled messages

The home front is no friendlier. As ever, Mr Blair rides high in the polls. But he is at virtual war with the

trade-union movement. To some extent, this is deliberate: Mr Blair has always insisted that his party can no longer be a creature of vested union interests. The present quarrel is the second half of one that started at the trade unions' conference last September 11th and was then put on hold for obvious reasons. But the prime minister has plunged back into the fight with singular ineptitude.

A fortnight ago, when the Tories were taunting him over the failing health services, Mr Blair leapt to the defence of the penurious altruists who toil thanklessly in hospitals and schools. Last weekend, in a bizarre reversal, he made a speech that appeared to denounce the self-same people as “wreckers” of his plans to make more use of the private sector in the public services. When this provoked the unions to fury, Downing Street's spin machine claimed implausibly that the wreckers the prime minister had in mind were the Tories, and that public servants who opposed his reforms were merely “small-c conservatives”. The unions, unconsoled, are now running newspaper advertisements with pictures of nurses holding babies and captions asking Mr Blair rhetorically whether these are “wreckers”.

Mr Blair may be on the right side of this argument. But he is prosecuting it without the discipline that characterised his first term, when every utterance was relentlessly “on message”. This may reflect growing isolation from a cabinet he has marginalised. His foremost political alliance, that with Gordon Brown, the chancellor, is too complicated by issues such as euro membership and the party succession to be a comfortable one. John Prescott, Mr Blair's nominal deputy, is on his way out and so less constrained to toe the line. Meanwhile, Mr Blair's impatience with the failure of his spending ministers to deliver the oft-promised reforms has become palpable. No wonder he misses Mr Mandelson, the arch-manipulator who made lots of enemies but helped to give Blairism a sense of direction.

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South Korean takeovers

Dead deals walking

Feb 7th 2002
From The Economist print edition

AP

South Korea has plenty of big companies that interest foreign investors. Why are they so difficult to buy?

Get article background

MICRON, an American semiconductor maker, is a relative greenhorn in South Korea. Two months ago, it started negotiating to buy Hynix, a struggling South Korean rival. Since then, it has already walked away and come back again once. This week it was facing a rival bid from Germany's Infineon, also something of a newcomer. To get an idea of what they are in for, both suitors might ask how other foreigners have fared in Seoul.

The answer is: not well at all. In January, after 18 months of negotiations, AIG, an American insurance giant and veteran investor in Asia, pulled out of a consortium bidding for the securities arm of Hyundai, formerly South Korea's biggest and proudest conglomerate (of which Hynix was a part until recently). General Motors has been in talks to buy Daewoo Motor, a bankrupt car maker, since September 2000, when Ford, which had been negotiating for six months, gave up. South Korea's government recently set a deadline (the umpteenth) to sell Daewoo by March. This week GM submitted a revised bid, though there is still much talking to do. HSBC and Deutsche Bank, two global banking groups, retreated after failing, successively, to reach a deal with Seoul Bank, which has been on the block for three years. Newbridge Capital, an American investment firm, stands out as a rare success. It took over Korea First Bank in 2000, after haggling for a mere 15 months.

Why is doing deals in South Korea such a nightmare? There are many reasons, most of them to do with South Korea's past. Once known as the “hermit kingdom”, the country began engaging with the world economy only a few decades ago—by exporting to it. It was only with the Asian financial crisis of 1997-98 that the country's bankrupt conglomerates, or *chaebol*, found themselves in need of foreign capital. Both for the South Korean sellers and the foreign bidders, the resulting contact proved a new—and very awkward—experience.

The trouble often starts with simple technical issues. In their heyday, the *chaebol* expanded into industries whose vital technologies were often owned by western or Japanese companies. This forced the South Koreans to license the technology; such deals usually bar any transfer to another company if the licensee is taken over. According to Stephen Schiller, an investment banker at Salomon Smith Barney, the problem of “borrowed technology” has spoiled many deals.

Another difficulty is a legacy of the *chaebol* structure itself. Even after a conglomerate is broken up, links

between its members remain. One part of a former *chaebol* often derives virtually all its sales from another part. To investors, this presents enormous risk. So do the country's labour unions, which are belligerent and can block restructuring plans.

Then there is debt. Many companies for sale are insolvent. More troubling, however, are their unknown debts, which often surface late in the due-diligence process and have been a problem in almost all negotiations. Hoping to protect themselves, foreign investors usually bid for specific assets (such as a factory), as opposed to whole companies, but this rarely works. The key sticking-points in the talks for Korea First and Seoul Bank concerned loans that might yet go bad.

Lack of good information aggravates the problem. The Enron scandal is a reminder that creative accounting is not solely an Asian speciality. Even so, the scale of number-juggling in South Korea is breathtaking. “All the people we started working with are now in jail,” says one long-time adviser to Daewoo, whose former chairman is hiding in exile. The sloppiness also extends to internal management accounts. Several foreign investors have discovered that their target companies never acquired the information-technology systems to collect details about cost structures and margins by product line.

Playing by different rules

All this may be off-putting. But risk can still be factored into valuation or the rest of a deal's terms. Why is this not happening? The biggest problem lies in the negotiating process itself. South Korea's negotiators are often new to mergers. Instead of looking for win-win propositions, say their western counterparts, they approach all talks as a zero-sum game. Any agreement, by this logic, means that they have conceded too much. One western negotiator remembers several instances when he struck a deal during the day, only to receive a phone call from the sellers in the evening asking for a higher price.

Korean culture does not help. Based on concepts such as “face” and “shame”, it offers no rewards for risky decisions that turn out well, but punishes—with jail, in some instances—those that turn out badly. The incentives for negotiators are thus stacked against completing a deal. One who has experienced this personally is Hogen Oh, who chaired Daewoo's restructuring committee. Seen by foreign investors as one of South Korea's bravest and best negotiators, Mr Oh was mauled in the local press last year for being easy on foreigners. “Afterwards, they can always say that you could have done better, and there is no defence,” says Mr Oh, who has since resigned and moved to Singapore.

Xenophobia plays a part too. South Koreans consider it a scandal that the head of one bank drives a Mercedes, not a domestic car. When Newbridge took control of Korea First Bank and installed a Japanese-American as chief executive, the staff threatened to resign en masse (though they subsequently accepted him). Many South Koreans distrust foreign investors instinctively and feel that the financial meltdown of 1998 shamed their country and made it vulnerable to a modern form of colonial exploitation.

This leads to paranoia and posturing by Korean negotiators. They feed leaks to the local press to gain stature—often, in doing so, breaking confidentiality agreements—but fear being criticised for selling the country cheaply. To prove “toughness”, they frequently storm out of meetings. “We tell our foreign clients to be prepared that the Koreans will walk at least five times, and that they should walk a few times too,” says one investment banker.

Another way to complete a deal is to go an extra mile to build trust. Newbridge was close to giving up in its talks to buy Korea First Bank when its negotiators offered one last concession. They promised the Koreans that, even after signing the contract, they could subsequently change items if they could show that these were unfair or illogical. That gesture created enough trust for the deal to go through.

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Philips

Struggling with a supertanker

Feb 7th 2002 | AMSTERDAM
From The Economist print edition

Philips's latest results suggest it is in a bad way. But it is changing

NINE months ago Gerard Kleisterlee took over as boss of Philips, Europe's biggest electronics group. Almost immediately, his supertanker headed into some of the choppiest market conditions it has ever known, forcing prices down by almost 10%. Following record profits in 2000, this week Philips announced a record net loss of *euro*2.6 billion ($2.3 billion) for 2001.

Last November Mr Kleisterlee unveiled cuts designed to reduce overheads by a quarter. Staff were asked for belt-tightening suggestions, and around *euro*150m of immediate savings were identified—bad news for Philips's consultants and telecoms providers. More than *euro*1 billion of savings will come later.

This nip-and-tuck style of management sits uncomfortably with the bold ambitions that Mr Kleisterlee outlined when he took over. From the outset he promised that he would transform Philips into a group whose high-tech expertise would be matched by world-class marketing and performance. He even said that revenues and earnings per share needed to grow, respectively, by 10% and 15% a year. To many observers, these targets seem crazy—and the underlying vision looks equally unrealistic.

Look a bit closer, however, and there are signs that Mr Kleisterlee has been doing a lot more than rationing paper clips. Indeed, the latest bouts of cost-cutting are actually helping him to strengthen his grip on Philips as he imposes a new way of doing business.

Mr Kleisterlee has, in short, been trying to turn the traditional challenge facing top managers on its head. “We used to start by identifying our core competences and then looking for market opportunities,” he says. “Now we ask what is required to capture an opportunity and then either try to get those skills via alliances or develop them internally to fit.”

The implications are profound. A new openness towards external partners has already resulted in groundbreaking deals, such as a joint venture in solid-state lighting with Agilent, a big American company, and a successful venture into the market for coffee machines in collaboration with Douwe Egberts, a Dutch coffee company. Equally striking has been the development with an arch-rival, Sony, of a new music system, known as SACD, that improves the sound quality of CDs. Philips has also embraced transparency with its customers, giving the most important complete access to its supply-chain systems, and setting up design teams with customers that save time and money by working jointly on web-based projects.

Mr Kleisterlee's return target, though absurdly tough, is forcing divisional managers to think in the interests of the group as a whole. A second spur comes from changes in how managers are rewarded, with more emphasis being placed on group performance rather than that of individual divisions. Mr Kleisterlee also holds monthly lunches to tease ideas out of ambitious younger managers, urging them to think of Philips as an open company with a single overall interest.

A good example of how this new approach works in practice is Philips's DVD recorder, launched ahead of competing products last summer. The team that created the machine spanned three operating divisions—semiconductors, optical systems and consumer electronics—and yet managed to meet accelerated design and production schedules. Moreover, the recorder's underlying technology grew out of collaboration with five rivals, including Sony, Ricoh and Yamaha. The old Philips might have tried to establish an industry standard on its own.

A further, little-noticed, element in the transformation of Philips has been a new willingness to kill off sacred cows through outsourcing. Last summer the company transferred its production of video recorders

(VCRs) to Funai, a Japanese manufacturer. Until recently, says Mr Kleisterlee, this would have been considered a “wrenching” move—after all, Philips was the world's third-largest video-machine maker. But he argues that it makes sense, in today's market, to concentrate on retail distribution for the mature VCR market, while developing in-house production expertise in next-generation DVD products. “We have to manage the life-cycles within our portfolio. That means recognising when a product is established, or even in decline,” he says.

Radical thinking indeed. Yet Philips's latest results are a stark reminder of the awful operating environment in which Mr Kleisterlee is trying to transform the company. He could be in for a long haul, especially if Philips's main markets take a long time to recover. Still, there is no denying that the captain has a clear idea of the direction in which he wants his supertanker to point, and how to turn it around. That makes a refreshing change from the Philips of old.

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Germany's cartel office

Böge's beefs

Feb 7th 2002 | FRANKFURT
From The Economist print edition

Germany's competition watchdog is busier than ever

AP

Rewiring the economy

IF SOMEBODY were daft enough to write a soap opera about German business, the choice of leading characters would be obvious. Most of the plot would be shaped by the deal-making, boardroom-battling bosses of banks, telecoms and energy companies, plus the odd politician and cash-strapped media mogul.

Room would still have to be found, though, for an unglamorous civil servant who has twisted several real-life plotlines in the past few weeks: Ulf Böge, the head of the Federal Cartel Office. Last month the competition watchdog stopped E.ON, a big energy utility, from indirectly buying 25% of Ruhrgas, Germany's biggest gas supplier, as the prelude to eventual majority ownership. The plan, said Mr Böge, would have left E.ON with too much control over the supply of gas to big customers. Because gas is an increasingly important fuel in electricity generation, it would also have cemented the dominance of E.ON and its rival, RWE, in the power business.

Although the decision may yet be reversed on appeal by Werner Müller, the economics minister (and, coincidentally, a former power-industry executive), the cartel office has put at least a temporary brake on the consolidation of Germany's energy business. It has not stopped there. The office has also taken ten local utilities, some of them part-owned by E.ON and RWE, to task for overcharging electricity suppliers for the use of their networks: their prices, says Mr Böge, exceed those of comparable firms by between 30% and 70%. In another case, RWE settled for a 20% stake in GEW Rheinland, a regional utility; the cartel office could and would have blocked RWE's original plan, to buy just over 25%, which would have given it a blocking minority.

It is not only in energy that Mr Böge has had something to say. He has warned Liberty Media, owned by John Malone, an American television tycoon, that he will not allow its *euro*5.5 billion ($4.8 billion) bid to take over most of Deutsche Telekom's cable-television assets as it stands. One of Mr Böge's objections is that Liberty, with 60% of Germany's broadband cable customers, would be too dominant. It is also a supplier of programmes, and so would have better access to cable customers than its competitors do. Its position would be reinforced by its plans to provide pay-TV through its own decoders.

Why has Mr Böge been so busy? One common thread, suggests Martin Hellwig, head of Germany's monopolies commission (which will have to advise Mr Müller on the Ruhrgas case), is the liberalisation of important industries such as telecoms and energy. As a result, these industries are in a process of rapid reorganisation, which tends to bring them to the attention of the competition authorities.

The cartel office's case-load is unlikely to ease up. Deutsche Telekom and Liberty must now rethink their plans. And more upheavals in the media industry look probable, now that creditors are piling the pressure on Leo Kirch, a Bavarian media baron whose empire is buckling under huge debts. Conceivably, a break-up of the Kirch group's assets could send more business Mr Böge's way.

In energy, RWE and E.ON, themselves the products of recent mergers, have been buying their way into the municipal utilities from which most Germans buy their electricity and gas. Of 60 such takeovers since the start of 2000, the two giants have been involved in 40.

The trouble, as the cartel office sees it, is that, unlike their competitors in Britain, RWE and E.ON, easily Germany's biggest energy companies, not only generate electricity but also supply it and own the networks over which it is distributed—to the disadvantage of other power producers and suppliers, and therefore customers. Mr Böge can, in effect, ensure that future purchases stay under 20%, the level below which he can no longer block them. Even these smaller shareholdings are unwelcome, says the cartel office, but that is the best it can do.

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Economist.com BUSINESS
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Barter

Juicy stuff

Feb 7th 2002 | STAMFORD, CONNECTICUT
From The Economist print edition

Making the most of an ancient business practice in a sagging economy

WHAT do boned chicken breasts, rollerblades and sauerkraut juice have in common? Answer: Icon International, a quirky little New England firm that dabbles in these products and much else. Icon's business is barter, whose ancient skills remain surprisingly popular. Last year, barter companies traded $7.9 billion in goods and services worldwide, according to the International Reciprocal Trade Association (IRTA). Recession, thinks the IRTA, will boost that figure by more than 20% this year, as companies dump unsold stock.

Barter companies buy and sell the same sort of challenging merchandise as “close-out” companies, which buy ageing stock and sell it on to hospitals, prisons and other unconventional outlets. Typical deals include once-hot items for which demand has ended abruptly (“I'm real long on robotic dogs at the moment,” says Icon's David Prose), or simply bad ideas, like the $2,000 lawnmowers painted in American football-team colours that Mr Prose has recently been trying to find a home for.

In part, barter experts are selling their remarketing skills. Manufacturers may have little or no control over where close-out companies offload their products. Icon, which has annual sales of $184m, works more closely with its clients. This might be important to owners of premium brands, who may not want last year's discounted gear on display with this year's full-priced stuff: Icon sells K2 Sports' old rollerblade models in Mexico and the Caribbean, not in America. But the big attraction of barter firms is price. Whereas close-out companies buy at a deep discount, Icon will pay the cost of production, or close to it. When it sells the product on, it is likely to recoup just one-third of that.

So how come it managed to make a profit of $24m before tax last year? Icon's secret is the currency in which it pays: so-called trade credits, which customers can exchange for business services, such as advertising and travel. Icon buys these services in advance, when it thinks that advertising space and airline tickets are cheap. The bet is that prices will rise, leaving Icon with a potential trading profit. These bets are then leveraged: in a typical deal, Icon sells three or four times as much in business services as it buys in goods, with customers paying in a mixture of trade credits and cash. And if Icon makes more on the advertising and airline-ticket trades than it loses on the sauerkraut juice, everybody wins—even if nobody will drink the stuff.

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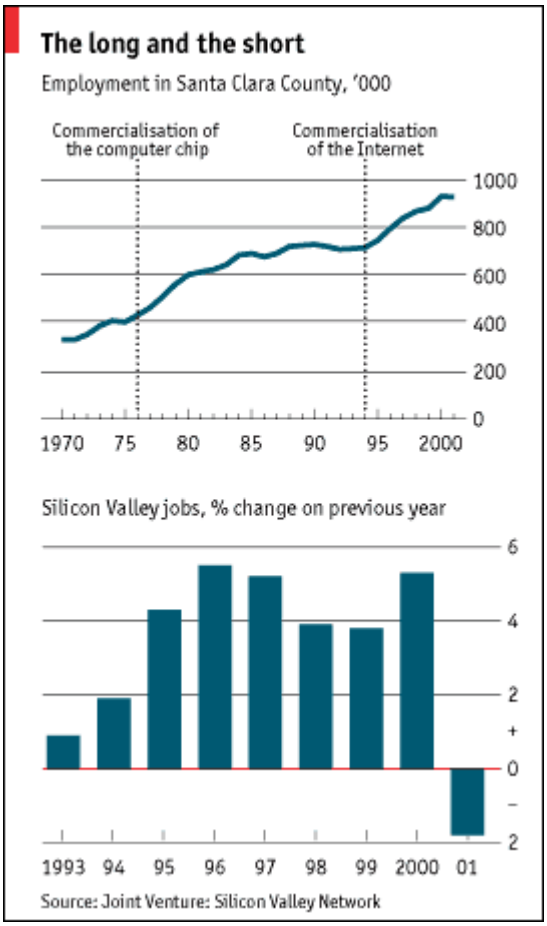
High-tech America

Down in the valley

Feb 7th 2002 | MOUNTAIN VIEW, CALIFORNIA
From The Economist print edition

Our first article on high-tech clusters in America looks at Silicon Valley's long-term problems. A second assesses the comeback of Boston's Route 128

SILICON VALLEY has rarely been in worse shape. More than 16% of its office space is empty—the highest level since 1990. Unemployment in Santa Clara County, the heart of the valley, has soared from 1.3% in December 2000 to 6.1%. And venture capitalists invested only $6 billion in the area's start-ups last year, a mere trickle compared with the $21 billion they handed out in 2000.



The valley is no stranger to boom and bust, observes Doug Henton, president of Collaborative Economics, a California research firm, and author of a recent report on it. Each cycle was triggered by new technology—integrated circuits, PCs, the Internet—and ended by external shocks, such as cuts in defence spending. Each time, it was the bust that created the foundation for the next boom. During the semiconductor recession of the mid-1980s, for instance, Silicon Valley firms shifted from commodity chips to higher-value microprocessors. The region thus appears well-positioned to be at the forefront of future waves of innovation, such as the wireless Internet and nanotechnology.

But the latest boom has shown that there are limits to the region's growth, at least in its current state. As the bubble inflated, the valley's quality of life declined. Only 23% of residents in the area around San Francisco Bay, of which the valley is part, now rate the region's quality of life as good—down from more than 50% ten years ago, according to a recent poll by the Bay Area Council, a public-policy organisation sponsored by local businesses. The most common complaint was the high cost of living in the region: 35% above the American average in 2000.

The core of the problem is land use. Mainly for tax reasons, but also because of strong neighbourhood opposition, the valley's local governments have preferred to approve new retail outlets and big single-family homes rather than apartment buildings. The result is a shortage of living space and ever-higher house prices. Despite the downturn, the valley still has as many as 82,000 fewer homes than it would need if it were to house all of its workers—a shortfall that is expected almost to double by 2010.

Unable to afford to live near their jobs, many workers are forced to commute, mainly by car, and thus lose hours each day on congested roads. All too often, public transport is an unattractive alternative. So fragmented is the transit system that many commuters have to change several times to get to their destinations.

Something is now being done about all this. A number of big public-transport projects are under way in the Bay Area, such as an extension of the BART rapid-train system into the valley. And politicians are approving more affordable and denser housing. These initiatives are starting to produce results. In 2001, more cheap housing was approved than in any of the previous four years.

But the valley needs to go further, because, as Mr Henton argues, its boom-and-bust cycles are likely to be shorter in future, forcing it to reinvent itself more quickly. It took other countries 15 years to compete seriously with Silicon Valley in semiconductors, but less than five years in Internet technology.

It remains to be seen whether the valley can become more resilient through social innovation. With its fiercely independent communities and an aversion to bureaucracy, the area has so far resisted any form of regional administration, relying instead on loose networks of politicians, local groups and businesses. To tackle its housing and transport problems effectively, though, the valley probably needs a regional government of sorts.

During the Internet boom, nobody was much inclined to think about these issues. Now, more of the region's business leaders appear to be getting involved. Yet most valley veterans still think there is no reason to worry: people complained about similar quality-of-life problems 20 years ago, but most stayed.

Maybe it will be the same this time around. Or maybe Silicon Valley will learn the hard way that no regional economy has the birthright to lead the next wave of innovation.

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Boston's high-tech suburbs

Revenge of the brahmins

Feb 7th 2002 | BOSTON
From The Economist print edition

Route 128's technology-heavy economy motors again

SILICON VALLEY may have the fame, but Boston was where it all started. Its east-coast techies were pioneering solid-state electronics when Santa Clara was still growing apricots and walnuts. With the rise of the personal computer, Boston's fortunes dimmed. Then came the early 1990s, carnage in Boston's minicomputer industry, and much local handwringing. East-coast culture was too old, too conservative and too insular to thrive in the open flats of the modern, networked economy. Boston's brahmins, bragged California's sneakered youth, simply did not get it.

Ten years on, the ones wearing sneakers are out of work and there is *Schadenfreude* on the east coast. Boston's high-tech suburbs, known collectively as Route 128 after the road they are sprinkled around (see map), have reinvented themselves from top to bottom. This recession has felt nothing like the minicomputer bust, when 400,000 people lost their jobs in 18 months, and well-heeled suburbs such as Wellesley were struggling to keep their houses warm in winter.

On the contrary, Route 128 is faring less badly than Silicon Valley right now. Unemployment has risen, but only to a little over 3%. Local venture capitalists, such as Polaris and Highland Capital, are raising money again. Nearly 440 software and Internet firms went bust last year, but 400 new ones were created in their stead, according to the Massachusetts Software and Internet Council, a local trade body. Boston did not avoid dotcom insanity altogether. “We went to the party and drank too much champagne,” says Sean Dalton of Highland Capital. “But we didn't break into the liquor cabinet and drink another ten bottles.”

Part of Boston's secret is the variety of its high-tech industries. Around the Massachusetts Institute of Technology (MIT) in Cambridge huddle recession-resistant biotech and bioinformatics firms. Stung, perhaps, by earlier criticism, the neighbourhood has acquired a certain self-conscious, west-coast informality. Deals get thrown together at the Au Bon Pain café and the Muddy Charles bar, where people on the make gather on Monday nights to network. Further to the west, around Route 128 and Route 495, cluster software companies, telecoms-equipment makers, data-storage firms (including EMC) and even the odd surviving Internet company, such as Monster, which runs a jobs board. When recession last hit, most of Boston's high-tech workers toiled in the minicomputer industry and its handful of big, old-fashioned manufacturers, such as Apollo, DEC and Data General. DEC alone employed more than 130,000 people. This time, Boston is better spread.

Those minicomputer makers took the blame for much of the region's supposed ills. Annalee Saxenian, whose 1994 book, “Regional Advantage”, still raises hackles in Boston, fingered the “secrecy, self-sufficiency and risk-aversion” of this old-line industrial community. Yet its collapse marked both an end and a new beginning. Hundreds of thousands of engineers and salesmen suddenly found themselves out of work. At first, people were scared, says Dan Bricklin, a DEC veteran and the inventor of the computer spreadsheet. After a while, they began drawing up business plans in their garages. Some of Boston's entrepreneurs, like Noubar Afeyan of Flagship Ventures, a venture-capital firm, are starting their second or third company. Mr Bricklin's latest company is Trellix, which writes software. Among the latest batch of high-tech tenants in DEC's old headquarters is Monster, the dotcom survivor.

MIT also took some flak in the early 1990s, but it has begun to retool. Since the appointment of Alex

d'Arbeloff in 1997 as chairman of its governing corporation, MIT has shaken off some of its reputation for ivory-tower frostiness. Mr d'Arbeloff is himself an entrepreneur (he founded Teradyne, which makes electronic-testing equipment) and has worked to bring business and academia closer together at MIT. As dean of engineering, Mr d'Arbeloff picked Thomas Magnanti, an academic from MIT's management school. He has also set free the energies of such people as Ken Morse, who runs MIT's entrepreneurship centre and its popular annual “$50K” competition ($50,000 for the best business plan). Underneath MIT's famous dome sits Mick Bass, a Hewlett-Packard employee who manages a five-year joint web research project with MIT Libraries. “We are learning,” says Mr Morse.

Maybe all this does not quite add up to another Silicon Valley. Cultures change only slowly, and Boston may never match California's adoration of entrepreneurial success, and its extraordinary tolerance of failure. Even now, says Flagship Ventures' Mr Afeyan, Boston society is harsh on all the “necessary failures” that accompany the odd Cisco. After the past couple of years, however, a little east-coast moderation may be no bad thing.

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Face value

The mixer

Feb 7th 2002
From The Economist print edition

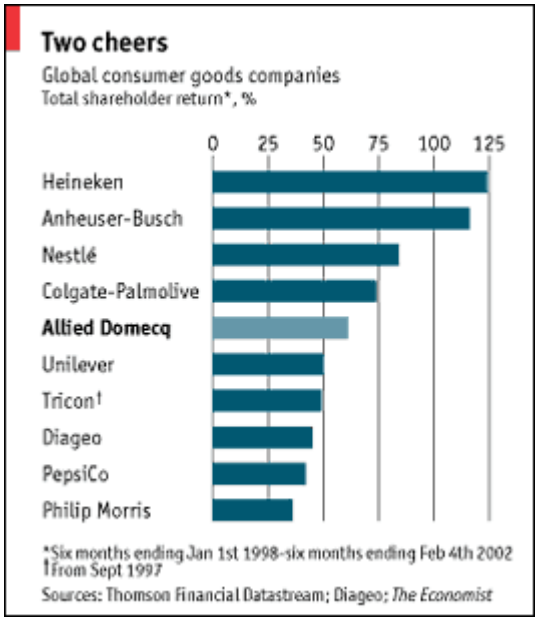
Philip Bowman has brought new-world thinking to old-world Allied Domecq

A NATIVE Australian, he grew up drinking Foster's lager and the sort of *Château Chunder* table wines lampooned in "Monty Python" sketches. Today, as chief executive of Allied Domecq, the world's second-largest wine-and-spirits company behind Diageo, Philip Bowman is in charge of some of the most refined tipples around, including Courvoisier cognac, Sauza tequila and Perrier-Jouët champagne. But although Mr Bowman is now accustomed to the taste of a good single malt, his new-world roots make him an odd fit in an industry traditionally dominated by old families, such as the Bacardis, the Ricards of Pernod Ricard and the Bronfmans who built Seagram.

It is hard, in truth, to fit the 49-year-old Mr Bowman into any establishment. Educated at two of Britain's most elite institutions (Westminster School and Cambridge), he studied medicine in Australia, but quit to follow his father into business. After stints as a financier in Germany, Iran and America, he spent ten years running the pubs and hotels divisions of Britain's Bass, before switching to department stores—Coles Myer in Australia and Liberty in Britain. He joined Allied Domecq in 1998, as finance director. In one respect, this was a return to his roots: his mother's French family had established the state of Victoria's first proper wine producer.

It was at Coles Myer that Mr Bowman first came to public attention, as the whistleblower who exposed a share-dealing scam by the vice-chairman. The scandal led the television news in Australia for three months and made Mr Bowman unemployable in his own country.

Such a willingness to take risks and challenge the establishment was clearly absent from Allied Domecq before Mr Bowman moved up to the top job in 1999. "Friends thought I needed to see a psychiatrist for joining Allied," he says. "The culture was ailing. People were incredibly risk-averse." That has changed under Mr Bowman, who has stepped up spending on advertising—something his predecessor, Tony Hales, neglected—and concentrated on a handful of big brands. Today, the top four (Ballantine's scotch, Beefeater gin, Kahlua and Sauza) consume half the marketing budget, but also deliver nearly 80% of the profits in Allied's wine-and-spirits divisions. Operating margins have risen from 17% to over 20% in the past three years. The balance sheet has been strengthened by the £2.7 billion ($3.9 billion) sale of the group's British pubs. With a total shareholder return well above Diageo's during the past four years (see chart), Mr Bowman has earned himself a generous glass of Perrier-Jouët.



Last chance?

Yet even as he was fixing Allied Domecq, his rivals have not stood idle. Last summer, Diageo and Pernod Ricard together bought Seagram's drinks business for $8.7 billion. Mr Bowman passed on a bid for the

Seagram assets, even though analysts expected Allied to fall irretrievably behind Diageo if it failed to buy them. “There were cartoons showing me in the Last Chance Saloon with Seagram walking away,” he remembers.

Instead, Mr Bowman tried to tie up a cunning side-deal to gain control of Captain Morgan rum, the Seagram brand that he coveted most, with Morgan's original Puerto Rican distillers, who had reclaimed ownership from Seagram under a change-of-control clause. Although the Morgan case remains tied up in court, Mr Bowman may soon scoop up a consolation prize. He is pondering dropping his pursuit of Captain Morgan in exchange for Diageo's existing rum, Malibu, which the number-one drinks company must sell to satisfy regulators.

Allied has gone on to make a number of other bolt-on acquisitions, including the Perrier-Jouët and Mumm champagne houses, and two big wine businesses, Montana in New Zealand and Bodegas y Bebidas in Spain. The wine deals have turned Allied into the world's third-biggest wine producer by sales, behind only America's Gallo and France's LVMH. Mr Bowman has also secured American distribution rights for Stolichnaya, a big-selling vodka, plugging another gap in the portfolio. Last month he formed a partnership with Miller, an American brewer, to introduce a range of ready-mixed drinks in America; this is a fast-growing niche dominated by brands such as Bacardi Breezer and Diageo's Smirnoff Ice.

The revitalised Allied is now in a strong position to take part in a fresh round of consolidation, which the Seagram deal seems sure to trigger. Mr Bowman already detects a change in attitude. “When I first talked to my peers about consolidation, they would say ‘you are right but it will never happen'. Now everyone is reappraising their strategic vision.” His favoured partners among those not yet in the Diageo camp are family-owned Bacardi, Brown Forman, which owns Jack Daniels bourbon and Southern Comfort, and the heavily indebted Rémy Cointreau. All three, he maintains, would fit better with Allied than Seagram would. Mr Bowman seems prepared to help finance a future acquisition by selling Allied's Baskin-Robbins and Dunkin' Donuts restaurants, which produce 13% of group profits and generate plenty of cash.

Not that Mr Bowman will have it all his own way. Even if he can strike more deals—never easy with such family firms as Bacardi—Diageo will be hard to catch, as its sales are four times Allied's. The spirits business is a hard slog. With volumes static or declining in developed markets, much depends on cracking emerging markets. Mr Bowman's forthright style can also ruffle feathers internally. He recently parted company with Todd Martin, the marketing-minded head of the American operations. Mr Bowman's new-world ways have changed Allied Domecq, but they are not to everyone's taste.

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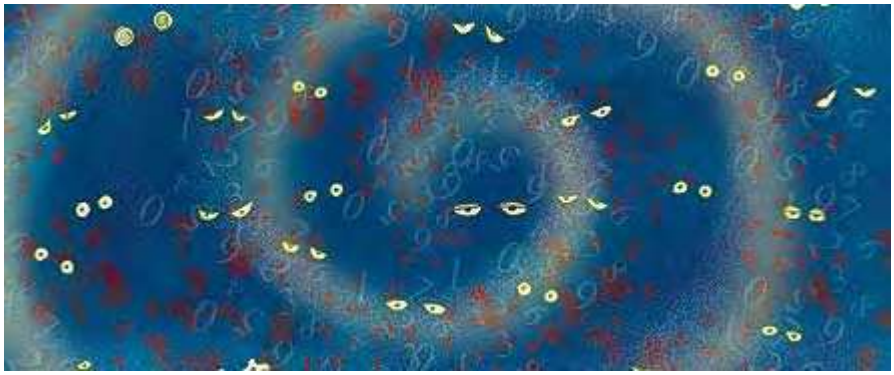
The trouble with accounting

When the numbers don't add up

Feb 7th 2002 | LONDON, NEW YORK AND SAN FRANCISCO
From The Economist print edition



To be efficient, markets need reliable information. Enron shows the extent to which they are not getting it

Get article background

RARELY has an accounting scam had such wide repercussions. As the fog surrounding Enron's accounts slowly lifts, investors are beginning to see what a mountain of muck it concealed. As a result, they have turned resolutely against companies with opaque accounts—from American blue chips such as General Electric to Elan, an Irish pharmaceuticals group whose share price halved on February 4th when it confessed to the deleterious effect of some hitherto undisclosed assets on its 2001 earnings.

External auditors have come under heavy suspicion. Andersen, Enron's auditor until the energy company filed for bankruptcy in December, is now the weakest link in a profession forced on to the defensive. And the failure of companies' internal audit committees to spot the transgressions has raised doubts about the effectiveness of “independent” non-executive directors.

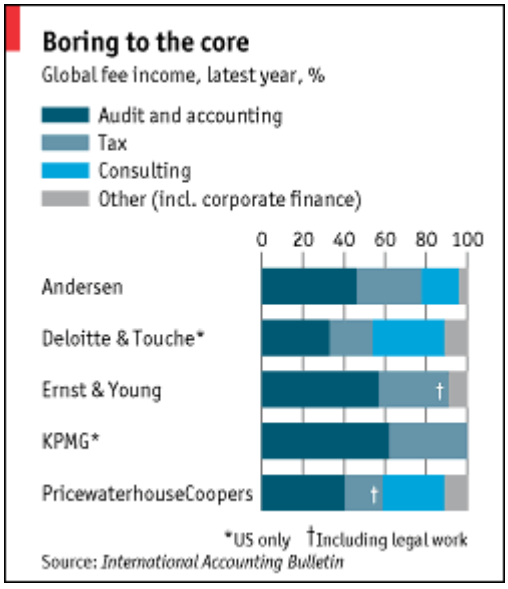
More importantly, the very tools of the auditors' trade—the accounting standards by which they measure a company's performance—are increasingly being questioned. What can be done to restore faith in accounts and accountants?

Accountants themselves have begun belatedly to clean up their act. This week Paul Volcker, a former chairman of the Federal Reserve and now chairman of the foundation that governs the International Accounting Standards Board (IASB), a body which oversees the harmonisation of accounting rules worldwide, agreed to chair a committee set up by Andersen to recommend reforms. Andersen has promised to implement whatever the committee recommends.

Auditor, audit thyself

One recommendation is likely to be a split of its auditing and consulting businesses. The conflict between the two has been controversial for some time. In 2000, Andersen earned more from Enron from non-audit services ($27m) than it did from auditing ($25m). A report submitted to Enron's board on February 2nd revealed details of further conflicts of interest between the two businesses. For example, Andersen earned $5.7m in 2000 by providing non-audit services relating to LJM and Chewco, two of the numerous “special purpose entities” (SPEs) that are at the heart of Enron's attempt to hide its true financial condition from investors.

Last week, PricewaterhouseCoopers, another of the big five firms which dominate the auditing of large quoted companies in America and Europe, brought forward the spin-off of its consulting arm. And this week Deloitte Touche Tohmatsu, the biggest international firm, said it too would separate its audit and consulting businesses, a route already followed in the last two years by KPMG and Ernst & Young (see chart). James Copeland, Deloitte's chief executive, says that the firm has not yet decided how to go about the separation, but it will have a plan ready by the end of May. Andersen, the fifth member of the big five, says it has begun to avoid doing non-audit work for audit clients as part of its post-Enron reforms.



These moves are not altruistic. Many clients are considering following the lead given by Unilever and Walt Disney. Both companies have announced, post-Enron, that they will not give any more consulting work to their auditors. Harvey Pitt, the chairman of the Securities and Exchange Commission (SEC), does not—unlike his predecessor, Arthur Levitt—think a formal ban is necessary, but says that “if Congress goes for it, I'll support it.” Britain's financial markets regulator, the Financial Services Authority (FSA), is contemplating a ban on firms carrying out consulting work for their audit clients.

Mr Levitt, who was chairman of the SEC from 1993-2000, campaigned to ban accounting firms from selling services such as consulting to their audit clients. At the time, Mr Pitt was on the other side of the fence. As a lawyer, he represented Ernst & Young and PricewaterhouseCoopers “as they negotiated appropriate independence rules with the SEC”, as he puts it.

Intense lobbying by accounting firms at the time forced Mr Levitt to agree a compromise whereby the firms would merely disclose each year how much they had earned from selling non-audit services to each firm that they audited. It showed that companies such as Motorola, Gap and Raytheon paid their auditors more than ten times as much for consulting as for auditing. At the time, Deloitte Touche Tohmatsu was the most fiercely opposed to the ban of all the big accounting firms. And this week it was unrepentant. The decision to separate auditing and consulting, said Mr Copeland, was made “very, very reluctantly. We do not believe this is a superior answer for auditing.”

Board stiffs

The Enron affair has also highlighted the failure of companies' internal audit committees (a subset of their board) to police their auditors properly. It is not yet clear why Enron's audit committee failed so completely, but questions are being raised about the conflicts of interest of some of its members.

Enron made substantial donations to the political campaigns of Phil Gramm, the senator husband of Wendy Gramm, the audit committee's chairman, as well as to a charity supported by Mrs Gramm. Lord Wakeham, a former British energy minister who was on the audit committee and who had a consulting contract with Enron, stepped aside last week from his job as chairman of the Press Complaints Commission, Britain's media watchdog.

The FSA has set out the responsibilities of the chairmen of British banks' audit committees, and made it clear that in the event of an audit failure, the chairman will be held responsible. At the Halifax, a large British bank, the audit committee's head now spends two days a week on his audit duties, and is paid commensurately. (A typical board member in America would consider two days a month to be a burden.) More pay and more time are certainly needed for audit committees to be effective. More important, though, is an independent frame of mind, and most boards tend to crush that rather than encourage it.

In the absence of adequate internal policemen, what other system of auditing the auditors might be effective? Nobody takes seriously the current peer review process, in which each of the big five firms gives a clean bill of health to another. Nor was America's Public Oversight Board, a private-sector body of five veteran executives from outside the industry, much use. Its members resigned last month after Mr Pitt proposed (without first consulting them) a vague new body to oversee the profession. One answer might be for a company's auditor to be chosen by a regulator, such as the SEC, or by a body like Britain's Audit Commission, which already chooses the auditors of local authorities' accounts.

Raising standards

The biggest accounting issue raised by Enron, however, is over accounting standards, the rules determining how companies should draw up their accounts. In America, these are set by the Financial Accounting Standards Board (FASB), a bunch of accountants who have drawn up a body of “generally accepted accounting principles” (GAAP). Other countries do things differently, and some follow the rules laid down by the IASB.

Mr Pitt says that he is supportive of the IASB and its idea of a single set of accounting standards for the world. Nevertheless, foreign companies wanting to list on the New York Stock Exchange still have to provide a reconciliation of their accounts with GAAP. Mr Pitt warns that any weakening of GAAP in order to converge with international rules is out of the question.

David Cairns, a former head of the IASB, thinks that after Enron America may accept that standards issued by other people can be as good or better than its own. Take, for example, the treatment of Enron's SPEs. For 20 years FASB failed to respond to requests to clarify the treatment of these. As a consequence, companies were allowed to leave very material items out of their accounts. International accounting rules on SPEs, as laid out by the IASB, are tougher and would, if applied properly, have forced Enron and its auditors to include them in the firm's accounts.

Mr Pitt has told the FASB to come up with a new standard for SPEs by the end of this year. But he wants to go much further and shake up the FASB itself which, he says, “is not performing satisfactorily”. “It does not set out enough principles, and those that it does take too long.” The recent appointment of Bob Herdman, formerly a senior executive at Ernst & Young, as chief economist at the SEC is encouraging more companies to seek the SEC's advice on what accounting rules they should follow.

Broadly, there are two main approaches to rule-setting. One is to define precisely how to deal with each and any situation. The other is to spell out rough principles and let auditors decide how to apply them. America has typically gone for precise rules rather than broad principles. Post-Enron, many people (including Mr Pitt) believe that this draws a road map for avoidance. If the rule says that above 10% an item should be shown, then those with something to hide go for 9.9%.

Areas where the accounting rules are still dangerously murky include:

• Off-balance-sheet activities. Companies use a variety of permitted devices besides SPEs to push either assets or liabilities off their balance sheets. These include leasing and securitisation. For example, an airline can own no planes in accounting terms, yet have long-term leases on them that are all but the same as ownership.

• Employee share options. These are clearly a cost of employment, yet they are not included in costs when calculating profits. The FASB had to back away from changing this after intense lobbying by companies, accountants and politicians. The IASB is currently under similar pressure as it considers the same issue.

• Derivatives. Assets are traditionally valued at historic cost (what they were bought for), but this makes little sense for financial instruments that swing wildly in value from day to day. There has been some progress towards valuing derivatives in real time (“marking to market”), but there is still a long way to go. One particular problem lies in the treatment of hedging, where a derivative is used to offset exposure to a real asset on a balance sheet which is not marked to market.

• Intangible assets. These account for an increasing proportion of companies' total assets, but they are largely excluded from balance sheets—whether they are relatively simple to value (like patents and licences) or fuzzier (like brands and goodwill).

• Revenue recognition. Companies have considerable discretion over when they book a profit or set aside reserves against a future loss. Global Crossing, for example, a recently bankrupted telecoms company audited by Andersen, leased capacity to other telecoms carriers and treated this as immediate revenue. At the same time, it leased capacity from other providers and treated this as a capital expense, amortising it over time. Likewise, Enron was able to record profits for a joint venture with Blockbuster Video that never actually got off the ground.

The manipulation of expenses presents a particular challenge because the arguments for doing it are often strong, even though the result can be misleading. A company called Pre-Paid Legal Services was forced by the SEC to restate (as expenses) some sales commissions which it had treated as assets. Richard Sloan, a professor at the University of Michigan, says such a practice can be justified because upfront costs are often incurred to create future revenue streams, to which they should be related in time. In the mid-1990s, Waste Management became notorious for the way in which it treated all sorts of routine expenses as the costs of acquiring contracts, costs that could thus be deferred for years. For a long time, that was how America Online treated the cost of acquiring its subscribers.

Another common way of distorting accounts is by “channel stuffing”. Companies such as Sunbeam, Lucent and Xerox's Latin American division attempted to meet ambitious quarterly goals in the late 1990s by reporting products as sold when they had merely been placed in a warehouse or on a retailer's shelf. Once there, they acted as an impediment to future sales and often had to be dumped later at low prices. That, in turn, forced the companies to restate their earlier profits.

High jinks in high tech

Confusing the picture even further has been the growing use of non-standard “pro-forma” accounting—particularly popular with the high-tech industry. Not content with creating a new economy, it has set about creating accounting rules to go with it. More than in any other sector, high-tech firms are calculating earnings not just by applying GAAP, but by using homemade formulas to exclude “special expenses”—a method that invariably makes the numbers look a lot better.

On February 4th, for example, Priceline.com, an online travel agency, reported a pro-forma net income of $3.3m, a sum that converted under GAAP rules into a loss of $1.3m. SGI, a computer maker, recently announced a “profit” of $400,000 after leaving out consulting fees of $10m for installing a new software system.

Amazon is often criticised for its confusing accounting practices. The online retailer surprised analysts in January by announcing a $5m net profit in its latest quarter, calculated under GAAP rules. In its press release about the figures, the company mentioned two other profits: “pro-forma operating profit” (of $59m) and “pro-forma net profit” (of $35m). The first number excludes stock options, amortisation of goodwill and restructuring costs; the second ignores things such as currency gains and losses, and something called the “cumulative effect of change in accounting principle”.

Many in the IT industry argue that pro-forma figures give a more accurate picture of a company's prospects than the official GAAP numbers, which include many non-cash and one-off charges. But their argument is weakened by the random way in which companies pick-'n'-mix their formulas. Comparing pro-forma results of different companies is nigh-on impossible; it is sometimes difficult even to compare the results of one period with those of another for the same company. The market, once blind to this legerdemain, is growing wiser. The shares of Priceline.com dropped by 24% after the announcement of its profit (and simultaneous loss). Silicon Valley folk fear that, thanks to Enron, any recovery in their stocks has been postponed even further.

People problems

There are at least two other problem areas for accounting. One is the quality of accountants themselves. Richard Leftwich, a professor of accounting at the University of Chicago, says that it is difficult for the accounting profession to attract able people because the work is seen as less creative than investment banking and consulting—auditing is basically a matter of checking somebody else's figures. “The starting salary is lower in accounting than in consulting,” he says, “so the quality of people attracted is lower.”

Accounting firms used to argue that their consulting businesses enabled them to attract a higher calibre of auditor because many of them had an eye on moving over to become consultants. That argument has been blown apart by the long line of accounting scandals. Now that accounting firms are in the process of getting rid of their consulting arms, they may be hoping that their corporate-finance work will fill the gap. It is a growing part of their business and could be the carrot to lure able people in to auditing for a while.

Another problem is not so much that auditors have an eye out for new business within their own firm, but that they have an eye out for a better-paid job with their clients. Enron's accounts and finance

departments were stuffed with former Andersen employees. And Joseph Perrone, Global Crossing's executive vice-president of finance at the time of its collapse, is a former Andersen employee who was leader of the audit team in charge of Global Crossing's accounts until he joined the company in May 2000. Strong personal ties such as these may well compromise the independence of the audit. When gamekeepers turn poachers they know very well which game to go for.

The second problem lies in the reading of accounts. Mr Pitt wants financial statements to be written in plain English, not in the current legalese. As he puts it, “the current system of disclosure is designed to avoid liability, not to inform anybody.” Most controversial of all, though, he wants to end the notion that there is one (and only one) correct version of accounts. “There is no true number in accounting,” he says, “and if there were, auditors would be the last people to find it.”

Instead he wants to shed light on the processes of calculation that lead to the numbers in the accounts. He has already ordered auditors to identify the five assumptions that make the biggest difference, and to show how the numbers would look were different assumptions made. In this he is on the right track. Accounting will always be as much art as science. Caveat lector.

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About sponsorship

Banks and credit risk

Bombe surprise

Feb 7th 2002
From The Economist print edition

Who can understand, let alone manage, credit risk?

Getty

IT IS a foolish driver who launches his car into a busy road on the say-so of his passenger, without looking both right and left himself. Yet that is exactly what some insurance companies and other investors are doing when they insure bank loans, bonds and other corporate debt.

They know little or nothing about the borrowers, sometimes not even their names. They insure a pool of loans, on the basis of a rating by a third party. And they are surprised and disappointed when more loans than expected go bad and they take a loss. This process is known as credit-risk transfer. Usually, the risk is transferred from the better- to the worse-informed.

It is a transfer running into hundreds of billions of dollars, and most people in the market believe it is a good thing: the risk is diversified, capital required to back loans on bank balance sheets is freed to make more loans, and the system benefits from a more efficient allocation of capital. Most central bankers welcome anything that moves risk away from the banks, for which they may have to provide liquidity, to entities such as insurance companies, for which they will not.

Some financial watchdogs, however, worry that a concentration of credit risk may be building up elsewhere, or may not have been perfectly passed on. If so, with a big enough corporate failure, or string of failures, a shock to the financial system would be amplified rather than absorbed.

The Bank of England and a joint forum of bank, insurance and securities regulators have published studies suggesting that the financial system is in no immediate danger. But their investigations show widely different treatment of credit risk by banks and insurers. That is not necessarily a bad thing. Banks and insurance companies do different jobs and have different time horizons. Regulatory arbitrage is fine so long as the regulations reflect different economics. It may be that medium-term bank loans sit better with insurance companies than with banks, and at less economic as well as regulatory cost.

But a weakness described in a study* by David Rule at the Bank of England is that not enough is known about the volume of loans and other debt transferred, or hedged, by banks. There is equally little information about the new owners' skills at managing credit risk.

There are several types of insurers, subject to many different jurisdictions, as another study†, by the joint forum, outlines. Some may be assessing credit risk accurately. Others may find the risk attractive simply because it is treated lightly by their regulators, the report suggests.

A big body of risk transfer—at least $300 billion—comes in the form of collateralised debt obligations

(CDOs). Typically, the repayment risk on a pool of 50-100 loans is sliced into tranches, with the lowest tranche (called the equity tranche) bearing any initial losses. If that is wiped out, the losses eat into the second tranche, and so on. The higher tranches are rated by rating agencies, with the top tranche—highly unlikely to be touched by defaults—rated triple-A. Often the CDO is synthetic, ie, only hypothetically backed by loans, and the insurer pays out cash as companies default.

The equity tranche is fondly referred to as the “toxic waste”, which banks often cannot sell and must keep on their books. At least the degree of loss here is reasonably well predicted. But regulators are beginning to worry more about where the best triple-A tranches go. Imagine, says one, that financial catastrophe strikes a whole bunch of triple-A tranches bought by a “monoline” insurance company (an insurance company set up with the sole purpose of guaranteeing such asset-backed securities). With the world crumbling about its ears, would the insurer be able to pay up?

Securities analysts believe that such circumstances would be so catastrophic that non-payment on CDOs would be only a minor concern. J.P. Morgan Chase, a big bank, certainly has few illusions about how much protection it would have in such a cataclysmic event, says Bill Winters, a managing director. (The bank should know: it is behind a lawsuit to make insurers pay up on a credit derivative related to Enron debt.)

Nevertheless, the edifice of CDOs and other structured products is heavily dependent on ratings by rating agencies. So, incidentally, are monoline insurers, since they were constructed to achieve a high credit rating. More and more off-balance-sheet financial activity is governed—some might even say driven—by what rating can be agreed with one of the main rating agencies, Moody's and Standard & Poor's.

André Perold, a professor at Harvard Business School, refers to a form of rating-agency arbitrage, whereby the formulae used by rating agencies will tend to give a better rating to assets put in special-purpose vehicles. And there is a danger, argues David Llewellyn of Loughborough University, that banks, rating agencies, insurers and even regulators may fall victim to a collective myopia that blinds them to the true risks of what is being packaged and distributed. He points to the sovereign syndicated loans of the 1970s, or the telecoms mania of only two years ago.

Mr Winters acknowledges that there is a danger if one market or even many markets use a standardised risk model: it could be wrong. “That's when you have to make your own judgment call. Am I diversified, am I liquid?” How to be sure that enough of those far-flung owners of credit risk ask themselves that question every day?

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*“Risk transfer between banks, insurance companies and capital markets”, by David Rule. Bank of England Financial Stability Review, December 2001.

†“Risk management practices and regulatory capital: cross-sectoral comparisons”, Joint Forum, Bank for International Settlements, November 2001.

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Allied Irish Banks

Oops

Feb 7th 2002
From The Economist print edition

Allied Irish Banks can survive a rogue trader; its independence may not

IT WAS only last month that Susan Keating, chief executive of Allfirst, one of America's 50 biggest banks, joined the executive committee of its parent company, Allied Irish Banks (AIB). It was, Ms Keating said, an affirmation of AIB's commitment to its American subsidiary. AIB may now be reconsidering that commitment, after the astonishing news that a foreign-exchange trader at Allfirst's Baltimore headquarters managed to lose $750m in unauthorised trading. The trader, John Rusnak, is now being grilled by the Federal Bureau of Investigation. Another Barings? Allied Irish has been swift to assure investors that the loss poses no threat to the bank's survival.

That is probably right, but its independence is nevertheless in doubt. News of the alleged fraud, which appears to have been concealed using fictitious options trades, was enough to send Allied's shares down by a fifth at the start of trading, though they later recovered a bit. The write-off raises questions about a management that was once highly rated. Rumours have resurfaced that Royal Bank of Scotland, one of Britain's four biggest banks since its acquisition of NatWest in 2000, is keen to add AIB to the stable.

Allied Irish Banks and its rival, Bank of Ireland, together dominate Ireland's banking market, with more than three-quarters of all deposits between them. They earn fat returns in their home market, but both have expanded overseas, partly because they know that home will not be so cosy forever. AIB always had the reputation of being the more innovative and better managed of the two banks.

Over the past few years, the speculation has been that one of the big two would be taken over, probably by a big British clearer. Both banks have British operations. Allied styles itself, brazenly, as the most popular bank to Britain's small businesses. Bank of Ireland, by contrast, concentrates on the retail mortgage market. It acquired the Bristol & West building society in 1996. But its credibility was hurt in 1999, when it agreed to merge with Alliance & Leicester, a second-tier mortgage bank, only to back out when investors rebelled.

Allied Irish has been more adventurous in its foreign expansion than has Bank of Ireland. It was one of the first foreign banks to invest in Poland, for instance. This investment proved astute, as it now owns one of the five biggest banks in a fast-developing market. Bank of Ireland, on the other hand, pulled out of America in 1997, forcing Royal Bank of Scotland, with which it had owned America's Citizens Bank, to buy out its stake. AIB had hinted at acquiring another bank to boost Allfirst, where growth has stalled. Now managers have the unenviable task of working out how on earth Allfirst's controls proved so inadequate. That might be the opportunity the Scots have been waiting for.

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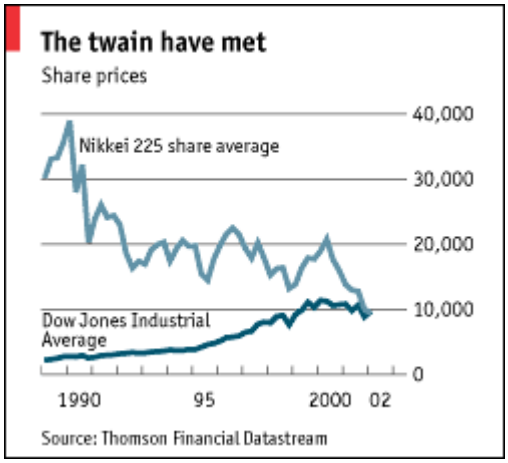
Japanese stockmarkets

Losing nerve

Feb 7th 2002 | TOKYO
From The Economist print edition

Mounting risks in the financial system



A GRIMMER week even than usual in Japanese finance. The Nikkei 225 share average fell below America's Dow Jones Industrial Average for the first time in 45 years; at its peak in 1989, the Nikkei was 15 times higher than the Dow (see chart). One rating agency, Standard & Poor's, cut the credit ratings of seven banks. Moody's placed seven life insurers on review for possible downgrades.

The stockmarkets form the battleground between investors, who demand that the banks and their equally sick debtors be sorted out, and the government, which seems to have abandoned recent promises of a sort-out. Investors are all the more frustrated, because late last year it seemed that the big banks, which have some ¥150 trillion ($1.1 trillion) of bad debts, were at last about to clean up their act. The government itself, in an effort to restore confidence by April, when it is due to lift its blanket protection of bank deposits, also hinted at a "controlled collapse" of some big companies with heavy debts to banks. Daiei, a supermarket chain with ¥2.6 trillion in debts, has become a test of banks' resolve.

When Daiei unveiled a fresh restructuring plan last month, it fell short of expectations. The retailer really needs to spin off the healthy bit of its operations, and sell or shut down the rest—a process that could cost creditor banks some ¥800 billion. But banks have promised only half that amount, leaving Daiei to muddle through again. One reason, says Hironari Nozaki of HSBC Securities, is that Sumitomo Mitsui Bank, one of three main creditors, whose budget for writing off bad loans is half that of the other two, UFJ Bank and Mizuho Financial, cannot afford any more.

Late last month Mitsui Construction and Sumitomo Construction, two duds in an overcrowded industry, announced that they might merge within a couple of years. Bank shares fell sharply again. Mergers will do little to ease oversupply in the construction business. So far there has been only one token failure.

On January 31st Tokio Marine & Fire, Japan's biggest property-and-casualty insurer, suddenly scrapped plans to buy the new-business operations of Asahi Mutual, a shaky life insurer, in March. Tokio Marine, whose share price had fallen after it announced a full merger with Asahi in 2003, postponed these plans as well. Asahi is now in deep trouble, desperate to get ¥100 billion from banks to boost its capital. Yet the fate of the country's fifth-biggest insurer, with ¥10 trillion of assets, is awkward for investors and bureaucrats. Propping Asahi up smacks of fudge. But its failure could harm Mizuho Financial, which holds a large chunk of Asahi's debt as well as Daiei's.

What really frightens investors is the risk of a domino effect. Confidence in the insurance industry could get shakier still, leading to more cancellations of policies and outflows of funds. Sumitomo Life and Mitsui Mutual would be especially vulnerable, with implications for Sumitomo Mitsui Bank, thought to have lent ¥415 billion to the two insurers. Although banks do not want to contemplate the collapse of big life insurers (which are, after all, among the banks' biggest shareholders), they cannot afford to do much to help.

Political credibility is at a low, particularly after the prime minister, Junichiro Koizumi, sacked his foreign minister, Makiko Tanaka, late last month. So when it comes to the banks, the government is trapped. Frustrated investors drag down share prices. This damages banks' share portfolios, and reduces their

ability to write off bad loans, upsetting investors further. At current share prices, banks are sitting on almost ¥5 trillion of equity losses, more than one-and-a-quarter times their annual operating profits. If the government waits too long, banks could become too weak to survive the reforms that investors demand.

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About sponsorship

The CFA franc and the euro

Give us our notes

Feb 7th 2002 | DAKAR AND OUAGADOUGOU
From The Economist print edition

The introduction of the European currency, seen from Africa

AP

Finger the fruit, but not the notes

ALLEES CANARDS is a pharmacy in downtown Dakar, Senegal, that has trouble securing a steady source of petty cash. There is a shortage of banknotes, and these are not large denominations: 1,000 CFA francs ($1.40), for instance, and 500 CFA francs. When street vendors cannot provide change, the pharmacist turns to the local church, which asks for something for its collection plate—larger notes—in return. Meanwhile, in Ouagadougou, capital of Burkina Faso, customers who are looking for 500 CFA franc notes at the Banque Internationale du Burkina (BIB) are often sent away empty-handed.

The West African central bank in Dakar, which oversees one of two CFA franc zones, explains that demand for notes has been on the rise, thanks to a good farming season, and the existing stock is insufficient. Moreover, it says, notes have a short life: they circulate fast and furiously, and quickly turn to shreds. But for the BIB's administrative manager, Ima Nézien, the culprit is none other than the euro. It is a French printer that supplies 15 African countries with their own currency. And recently the printer has been too busy producing euros for the market back home.

The CFA franc was created in 1945 as a colonial currency. It survived independence by retaining its peg to the French franc, together with a guarantee from the French Treasury of convertibility. Although they share the same exchange rate, CFA countries in West and Central Africa are grouped into two distinct zones. The West African Economic and Monetary Union and the Central African Economic and Monetary Community each maintain not just their long names, but their own central banks. Members' foreign-exchange reserves are pooled; each central bank keeps 65% of its foreign reserves with the French Treasury. To ensure monetary discipline, foreign reserves must equal at least 20% of the central banks' short-term deposits. In the late 1980s, the CFA franc became increasingly overvalued, thanks to unfavourable trade terms and fiscal ineptitude. In 1994, for the first time, the CFA franc was devalued, by no less than half.

Plenty of west Africans, especially businessmen, now fear that the arrival of euro notes and coins means that another devaluation is on the way, despite the authorities' best attempts to reassure. After all, the CFA franc had, in effect, been pegged to the euro, via the French franc, since 1999. Given that Europe is the region's main trading partner, the adoption of the euro ought perhaps to be good news, because it removes even more foreign-exchange risk.

West and Central Africa's exchange rate no longer seems so overvalued as it did. Inflation in the region

averages under 2%—compared with roughly 17% in sub-Saharan Africa—and foreign reserves stand at healthy levels. Budget deficits have been cut; the Central African zone even ran a surplus in 2000. Public debt remains a thorn in the region's side, but most CFA countries should see some of the burden eased by debt relief for heavily indebted poor countries.

The situation is not all rosy, though. Economic growth in the CFA area averaged 2.4% in 2000, lower than sub-Saharan Africa's 3.1%. This hides sharp differences: West African members have suffered from a slump in commodity prices, hitting Côte d'Ivoire, with two-fifths of the zone's GDP, particularly hard. Central African economies—which include oil exporters—have cashed in on higher prices for oil and wood.

Another devaluation may not be on the cards, at least in the short term, but there are a few questions about the future of the CFA franc. Although member countries remain attached to their currency—and the price stability it provides—a continued imbalance between growth in the West and Central African zones could eventually lead to misaligned exchange rates.

Another uncertainty is that the Economic Community of West African States (ECOWAS)—which includes eight CFA countries, plus Nigeria, Ghana, Guinea, the Gambia, Cape Verde, Sierra Leone and Liberia—is also talking about regional monetary union. If this ambitious project ever takes off, the question will be what common currency to link to. Some ECOWAS members are not keen on the CFA franc and its French guarantee, which they see as neo-colonial. Expanding the CFA family would require a nod from European authorities, who may frown at some candidates' history of instability. But if this does not bury ECOWAS's dreams of monetary union, it could spell the end for the CFA franc in West Africa.

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American productivity

A profitless recovery?

Feb 7th 2002 | NEW YORK
From The Economist print edition

America's stockmarket has priced in an unrealistically sharp rebound in profits

PERHAPS the most common observation at the annual meeting last week in New York of the World Economic Forum, that feast of self-congratulation by the business and political elite, was that most businessmen are gloomier about America's economic prospects than most economists are. The latest figures may signal that the recession is over, but corporate America fears a rather weak recovery.

In particular, bosses' profits have sadly diminished. This may have been one of America's mildest recessions of the past half-century. But for companies, it was the deepest recession by far: profits showed the biggest year-on-year decline since the depression of the 1930s. Looking ahead, the concern is that profits could disappoint during the recovery, too.

Equity analysts, on average, forecast a 37% rise in the profits of companies in the S&P 500 index over the year to the fourth quarter of 2002. Even if that profit growth is achieved, the current level of share prices would still imply a price/earnings ratio (share price divided by earnings per share) of 21—historically high, and well above the long-term average of 16. More likely, profits will rise by a lot less.

This week's news that productivity growth jumped by an annual rate of 3.5% in the fourth quarter of last year was welcome. As a result, unit labour costs fell in the quarter. If maintained, such productivity growth would help boost profits. Bear in mind, though, that quarterly GDP numbers are volatile. A more reliable gauge is the increase in productivity from a year earlier, a more modest 1.6%.

In a workshop on the new economy at the forum last week, a consensus emerged among economists that annual productivity growth had increased to a sustainable 2-2.25%, up from an average of 1.4% in the two decades to 1995. This means that the American economy, and perhaps profits, can indeed continue to grow faster over the coming years.

But not as fast as the assumptions of double-digit growth in profits that are built into current share prices. What is more, productivity growth is not the same as profits: it depends on how the gains are split between producers and consumers. Faster volume growth may for a while be partly offset by narrower profit margins. Intense competition can force firms to pass the savings achieved through productivity on to consumers in lower prices.

This partly explains why, even before the recession began and despite faster productivity growth, the profits of non-financial firms fell from 12.5% of GDP in 1997 to 9% of GDP at the end of 2000. Individual companies that innovate or cut costs radically will still thrive, but for corporate America as a whole, the next year or so could be bumpy.

Two particular forces are likely to cramp the growth in profits over the next year. The first is unusually weak growth in nominal GDP. Real GDP unexpectedly rose in the fourth quarter, but in money terms GDP fell slightly. The year-on-year growth in nominal GDP fell to 1.9%, the smallest increase for 40 years.

Many companies increased their sales in the fourth quarter only because of heavy discounting, selling products at a loss. Inflation should continue to fall in the United States over the next year, as abundant

spare capacity persists. So even assuming a fairly robust recovery in real GDP in the second half of 2002, nominal GDP growth over the year is unlikely to be more than 3%. Farther out, nominal GDP growth may possibly average only around 5% over the next decade. In the long run, profit growth cannot outpace growth in national income. So hopes of future double-digit growth in profits are unrealistic.

A second dampener on profits is that almost all the rest of the world economy is fragile. Overseas earnings account for more than a quarter of American firms' profits. As the forum heard repeatedly, Japan's economic prospects are getting ever worse; and, although there are signs of a pick-up in Europe, it hardly looks like an engine for global growth.

A capacity glut, especially in Asia, is exporting deflationary pressures to the United States. Prices are falling in China, Japan, Taiwan, Hong Kong and Singapore, which together account for one-fifth of world GDP. In this environment, American firms cannot easily push up prices. Not only is foreign demand likely to stay weak, but the strong dollar (in trade-weighted terms, currently at a 16-year high) is eroding American exporters' market share.

Bruce Kasman, at J.P. Morgan Chase, says that this could be a repeat of the economic recovery after recession in 1970. That, too, was a mild recession, thanks to monetary and fiscal easing, but profit margins were not restored, leaving companies more vulnerable to the next downturn. The recovery of the early 1990s was famously called the jobless recovery. It will be investors, not employees, who will feel the pain now of a profitless recovery.

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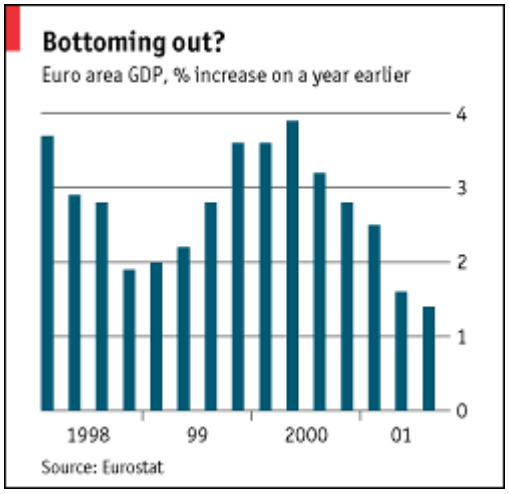
The European Central Bank

Adieu, Wim, eventually

Feb 7th 2002 | FRANKFURT
From The Economist print edition

The ECB's president announces his departure



RELIEF for the French: on February 7th Wim Duisenberg, president of the European Central Bank (ECB), promised to quit. By the laws of europolitics, they will probably nab a job they covet—but not until July 9th 2003, Mr Duisenberg's 68th birthday, pointedly five years into his eight-year term. The French say Mr Duisenberg agreed to go half-way through (a deal he denies) and may now have 14 months with no representative on the bank's executive board. But the delay should allow their man, Jean-Claude Trichet, head of the Bank of France, to put a pesky judicial investigation behind him.

As for the ECB's main business: setting euro-area interest rates, the day was quiet. Meeting symbolically in Maastricht, the bank left rates unchanged, at 3.25%. Although cuts may follow, in the current gloomy mood—German unemployment rose sharply in January—there are signs the euro area's economy is bottoming out.

So far, this is more hope than fact. With better news from America, and a weakening euro, a clutch of recent monthly surveys, from Germany, France and the euro area as a whole, suggest that business confidence is picking up after its post-September 11th fall. There are signs that consumers' outlook too has at least stabilised.

There have been few more solid signs of recovery, although one index published this week suggested that activity in service industries was expanding for the first time since August. Moreover, none of the surveys point to a swift, strong recovery: at best a small increase in euro-area GDP in the first quarter of the year, after a probable contraction in the fourth quarter of 2001. In any case, so long as growth is below long-term trend, the gap between actual and potential output will continue to grow, easing inflationary pressure. That should mean that there is still scope for the ECB to cut rates.

But how much? The ECB's job is to keep prices stable—a task it defines as keeping inflation below 2%. In January the rate jumped to 2.5%, from 2.1% in December—largely because many prices were rounded up when euro notes and coins were introduced at the turn of the year. Most economists still expect inflation to fall in the coming months, but the starting-point is now higher than forecast. Core inflation (ie, stripping out food and energy) is also above 2%, and it has been rising.

Ironically, the wretched German labour market is another reason for caution. Despite the high rate of unemployment, the country's biggest trade union, IG Metall, is pushing a pay claim of 6.5%, compared with an inflation rate of 1.7%. In recent years, it has settled for far less than it has asked for, and many German wage settlements these days bypass industry norms. Nonetheless, the ECB will doubtless keep careful watch: the virtues of moderate pay deals have been a regular topic of Mr Duisenberg's sermons.

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Reinsurance

Premium rates

Feb 7th 2002 | LONDON AND ZURICH
From The Economist print edition

Reinsurers are taking on less risk, at a higher price

EVERYTHING has changed, says Walter Kielholz, chief executive of one of the world's biggest reinsurers, Swiss Re. For most of the past decade, reinsurance was an industry with both capital (much of it invested in stocks and bonds) and the capacity to underwrite. Last year, it became clear that falling stockmarkets worldwide were eroding reinsurers' capital. Then came September 11th. Insurance claims from the attacks are now believed to exceed $40 billion; of that, reinsurers will be hit for about two-thirds. One consequence is that reinsurers will have less capital when reinsurance policies are renegotiated—and what they have they are not keen to risk. Rates have risen sharply.

Reinsurers insure insurers. They tend to cover either an agreed amount of an insurance company's risk, or any claims above a given threshold. When the market is “soft”, that is, when insurance is cheap and capital is plentiful, reinsurers are not too picky about what risks they underwrite. In the 1990s property-and-casualty policies were reinsured at risibly low cost.

September 11th was not the only blow to reinsurers last year. Munich Re's losses from its investments were over twice the $2 billion it lost on terrorism. Still, even big reinsurers stung by the attacks—including Munich and Swiss Re (which lost $1.5 billion)—can take the pain, although more attacks would be another matter.

There is even a prospect of a bumper year ahead. Reinsurance rates rose by more than 20% at the start of the year, when the bulk of reinsurance contracts are negotiated. The rise was steeper in some areas, such as cover for commercial property. The terms of contracts have changed, too. Reinsurers have cut the proportion of risk they are prepared to cover and raised their deductibles—ie, the threshold at which reinsurance kicks in. Jacques Blondeau, chief executive of SCOR, a French reinsurer, says his firm used to underwrite on “an everything-but basis”. Now, he says, it covers only risks that have been explicitly spelled out.

For smaller reinsurers, the rate rises are not enough to keep them in the business. Copenhagen Re no longer signs new reinsurance contracts. Alleghany, an American insurer, has got out of reinsurance, because of terrorist-related risks. St Paul Re, in Minnesota, cut its reinsurance operations by four-fifths in December. Taisei, a middling Japanese reinsurer that had planned a merger with two others, filed for insolvency in November. For survivors, less capacity means more profits.

Yet the bane of insurance is that every time rates rise, new capital rushes in, bringing rates down again. Will it be different this time? Perhaps not.

Axis Speciality, a new Bermuda reinsurer, has $1.6 billion in fresh capital from the private-equity arm of Marsh & McLennan, a big insurance broker. Allied World, another new reinsurer, has $1.5 billion from its parents, AIG and Chubb, two big American insurers, and Goldman Sachs, an investment bank. Established reinsurers are also committing new capital. In November Swiss Re raised $3.3 billion by issuing equity and convertible bonds. In a letter to shareholders, Warren Buffett, chairman of Berkshire Hathaway, which ran up reinsurance losses of $1.3 billion in the fourth quarter, predicts that the market will be soft again in a year's time.

Yet capital will not be committed with the abandon of earlier years. For now, most reinsurers refuse to write terrorist risk in America. They say that terrorism is unsuitable for commercial insurance, and that the government should be the insurer of last resort. Congress has so far failed to approve legislation, though it is surely only a matter of time. *Le hyperterrorisme,* says Mr Blondeau,is now uninsurable.

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Economics focus

Champions of trade

Feb 7th 2002
From The Economist print edition

Free trade needs persuasive advocates. It has two, at least

THIS column believes that you cannot have too many good books defending the case for liberal trade. After a recent shortage, two fine specimens have come along together. They read surprisingly well in quick succession. They are short enough, and clear enough, for that to be no burden. And although they agree that free trade is good, their styles of argument are contrasting and complementary. If you are for free trade, you will find your understanding deepened, and your arguments sharpened up. If you are against, and somehow stay that way, you will at least have exposed your thinking to the best that the other side has to offer—and that is always an instructive thing to do.

Jagdish Bhagwati's “Free Trade Today”, is just out; Douglas Irwin's “Free Trade Under Fire”, is due for release in April. (Both volumes are from Princeton University Press.) Mr Bhagwati, a professor at Columbia University, is a pioneer of modern trade theory and the most distinguished scholarly advocate of liberal trade. Mr Irwin is his former student, now a professor at Dartmouth, and a leading economic historian. Both start from the same premise: that the case for liberal trade now faces greater and more dangerous opposition than it has done for years, and that this opposition needs to be confronted and out-argued. They take up that challenge in different ways.

Mr Bhagwati's book comprises three lectures given at the Stockholm School of Economics. The first reviews the shifting character of arguments against trade down the years. The second looks more closely at the new concerns about trade, and in particular at the supposed “race to the bottom” in labour and environmental standards. The third weighs the main approaches to achieving freer trade, whether by unilateral action, by multilateral agreement, or by regional arrangements such as the EU and NAFTA.

This a quite a swathe for a book of 128 pages, and compression has a price. “Free Trade Today” is mostly accessible and steers clear of technicality, but Mr Bhagwati was talking to economists and economics students, and it shows—especially in the first chapter, which zooms through the intellectual history of anti-trade thinking. Without at least some familiarity with such names as Lionel Robbins, John Hicks and Edward Chamberlin, readers may struggle to keep up. Economics is about trade-offs: a little bit of accessibility has been sacrificed here in exchange for conciseness and breadth of reference.

One of the best things about the book is that it confounds stereotypes. Mr Bhagwati, it emerges clearly, is a liberal in both the old and new senses of that word: he is for free trade, but he is for ambitious social policies too. He thinks concerns about a race to the bottom are “empirically irrelevant”—it isn't happening—but he then accepts the logic of that position and says that rich-country foreign investors should be required to observe rich-country environmental standards when investing in the third world. It would make no difference to what they do, Mr Bhagwati says, and it would quash one of the anti-globalists' favourite arguments.

Mr Irwin and Mr Bhagwati agree on a central theme: distortions in markets of one sort or another (labour-market blockages, environmental externalities, credit-market bottlenecks and so on) mean that it cannot be taken for granted that free trade is best. But, they explain, the right remedy—in theory, and even more so in practice—is nearly always to attack the issue directly, with a tax, a subsidy or a regulation, and then let trade be unrestricted. Using trade policy to remedy such ills not only deprives the world of the gains from trade, but will often fail even on its own terms.

Of the two, Mr Irwin's book is organised in a more familiar and straightforward way. He states the standard objections to free trade and goes through each in turn, explaining and questioning the theory, and then checking the empirical evidence. He concentrates on the new criticisms and the most recent

evidence. “Free Trade Under Fire” is bang up to date with the current literature on trade and incomes, trade and growth, trade and jobs, and other newly contentious issues; any reader who wants to be the same can spare many a weekend plodding through journals and working papers by relying on Mr Irwin. A wealth of reporting, both of trade-theory debates and of recent political battles in America over trade, is elegantly squeezed into the book. A chapter on anti-dumping—which, Mr Irwin explains, is the measure most used nowadays by rich countries seeking to keep out imports—is a particular strength.

Mr Bhagwati is encouraged by the difference between old-style protectionists and their anti-globalist successors: the new lot, not in the main self-interested, may be open to persuasion. Mr Irwin is less sanguine. He stresses another difference: many of the anti-globalists are opposed to trade because they see it as part of the much bigger problem of wicked global capitalism. If Mr Bhagwati is right about the open-mindedness of some of the opposition, these books should win converts. If Mr Irwin is right about the depth of anti-capitalist convictions, that is unlikely. In any event, if the books do not change trade sceptics' minds, it is hard to think what else would.

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Security technology

Where's the smart money?

Feb 7th 2002
From The Economist print edition

Money of the future may almost literally talk

AMERICAN banknotes bear the motto “In God we trust”. A humorous extension to this phrase—ascribed, unofficially, to the National Security Agency—is “All Others, we monitor”. That joke, though, may soon pale into reality, for such a phrase might well be a suitable slogan for the cash of the future.

Radio-frequency identification tags (RFIDs) are widgets that are used all over the world for granting access to secure areas. They are also used to track anything from books to pallets to cattle to Prada handbags. Their advantage is that each tag (and therefore each object) can be identified uniquely. That makes them different from, say, bar codes, which merely identify classes of object. Also unlike bar codes, RFIDS can be read remotely without having to be in the line of sight of the reader. In recent years, their manufacturers have been drooling over the possibility of tagging banknotes. The advantages envisaged are a combination of authentication, anti-counterfeiting and tracking.

In the money

The guts of a typical RFID tag are a microchip and an antenna (often a coil of wire). These may be sandwiched inside an encapsulating plastic. There is no battery. When a tag is “interrogated” by a reading machine operating at the right radio frequency, the antenna picks up a small amount of electromagnetic energy that it uses to power the chip. The tag then broadcasts data in the chip back to the reader.

A new generation of RFID tags produced by companies such as Texas Instruments in America, Hitachi in Japan and Infineon Technologies in Germany, has broken through barriers of size (less than 1mm across and ½mm thick), cost, flexibility and durability, to a point where such tags can be embedded inside sheets of paper, such as banknotes.

The distance from which tagged banknotes could be read would depend on the exact specifications of the chips that were used. It would probably be somewhere between 10cm and a metre. One form of the technology can read 30 notes a second, although the tags have to be separated from each other by a distance of at least 2cm to reduce interference. Initially, therefore, bundles of notes could not be read; but notes being issued from cash machines, or passing from customers to tills, could.

The technology remains relatively expensive (20-30 cents a chip), and there is still work to be done hammering out what people want in the way of security standards, durability and the amount of information that can be stored. But Infineon says that these problems could be ironed out within 30 months, and possibly much faster than that. Critics sound a warning, however, that long delays are likely in reaching an international agreement on a cryptographic security standard.

One bank, at least, seems interested in the idea. Late last year, *Electronic Engineering Times* reported that the European Central Bank (ECB) was working with “technology partners” to embed the tags into euro notes by 2005—as a means of foiling counterfeiters. The ECB will only say of the project, “we don't want to talk about this.” Nevertheless, two chip manufacturers, Philips and Infineon, admit to having signed confidentiality agreements with some firms in the industry. Hitachi says it has been discussing the issue with European banknote makers.

Obviously, such tags would make counterfeiters' lives far more difficult. But according to De La Rue, a British firm that is one of the world's leading “security” printers and paper makers, the ECB is already aware of many new anti-counterfeiting technologies that would be just as robust as, and less expensive than, RFID. If this is the case, the additional benefits of RFID banknotes—such as the greater ease with which cash could be tracked—are the likeliest explanation for why the technology is now attracting serious consideration.

RFID-tagged notes mean that it would be possible to gather “real-time” inventories of notes within banks. And, if cash registers were equipped with authorised readers (tags can also interrogate reading machines to establish a reader's “authority” to ask particular questions), details of the transaction and the notes involved could be collated in a central database.

Accurate knowledge, and monitoring, of the population of banknotes could be a powerful tool. The mining of data on how different banknotes move through the economy would make it easy to spot suspicious transactions—for example, a large deposit of notes that had been out of circulation for a long time.

There are further possibilities. Known notes could be slipped into the “informal” economy by law-enforcement agencies that wanted to find out where they turned up. Kidnappers could no longer insist on unmarked bills, for there would be no such things. Even the theft of cash would become a much trickier affair.

Clearly, the technology would have huge privacy implications. On the one hand, customers of illicit and semi-licit goods and services, such as recreational drugs and prostitution, would risk losing their anonymity unless they were careful. On the other, ham-fisted policing might implicate the innocent in transactions to which they had not been a party, merely because they once handled suspect notes.

Nevertheless, it is likely that the threat of terrorism and organised crime, and the precedent of existing methods for tracking money, will be strong counter-arguments in favour of tracking technology. The relatively high cost of the tags has led to speculation that they would be practical only in high-value notes—in the case of the ECB, *euro*200 and *euro*500. But it is just such notes that are of concern to agencies such as Britain's National Criminal Intelligence Service, which warns that these new denominations make it easier to move large amounts of currency discreetly (and possibly illegally) around the world. The global reach of the euro, a currency that is policed by a fragmented group of authorities, highlights weaknesses that RFID technology may be well-placed to rectify. For criminals, money may no longer talk. Instead, it may squeal.

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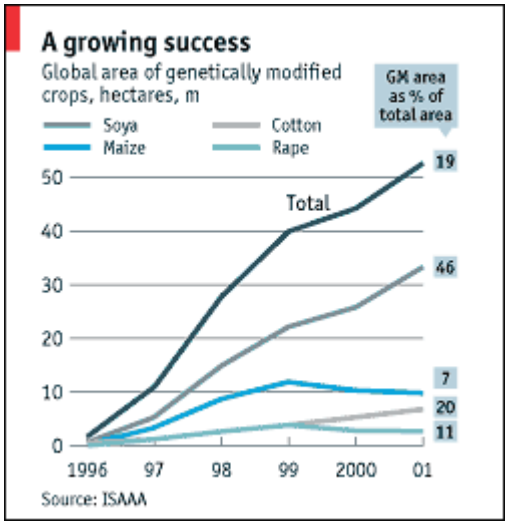
Genetically modified crops

Seeds of uncertainty

Feb 7th 2002
From The Economist print edition

Some advantages and disadvantages of genetic modification



IT HAS been a mixed week in Britain for genetically modified (GM) crops. On the plus side, a report by the Royal Society, the world's oldest scientific organisation, has cleared them of the charge of damaging people's health. On the minus side English Nature, a quango with responsibility for the environment, has published evidence that they might end up creating a new class of weed.

The Royal Society's experts looked at data gathered since 1998, when a scare about the effects on rats of experimental genetically modified potatoes appeared to put the British public off the whole idea. They have concluded that existing GM crops pose no more risk to human health than do conventional foods. On the issue of testing new foodstuffs, whether modified or unmodified, they call for a more systematic approach to establishing “substantial equivalence”—the principle that GM and conventional foods are equally safe so long as they have the same composition. They also recommend that new technologies, such as microarray analysis of gene activity, be used by regulators alongside conventional assessments of nutritional value and toxicity.

English Nature has been assessing the ecological impact of GM crops. One of its concerns is that genes from a GM species might flow into unmodified neighbours, producing undesirable traits. This is just what it found when it commissioned a study of rape growing in the Canadian prairies. Roughly 80% of the crop there has been genetically modified to resist one of three different herbicides used to kill weeds.

Canadian farmers have, however, discovered after three growing seasons that their fields are filled with stray crop plants known as “volunteers”, which are resistant not only to the substance against which the main crop is engineered, but to the other two as well. This is because the volunteers have picked up genes from pollen wafting in from neighbouring fields that were genetically modified to resist the other herbicides, a phenomenon known as “gene stacking”. Such volunteers could easily turn into ineradicable weeds. So, while human health seems none the worse for GM crops, the health of the environment remains in doubt.

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About sponsorship

Computers and language

The elements of style

Feb 7th 2002
From The Economist print edition

Analysing compressed data leads to impressive results in linguistics

ZIPPING, as any computer buff knows, enables you to compress a file so that it can be stored efficiently, or sent quickly over the Internet. But Emanuele Caglioti and his colleagues at the University of Rome-La Sapienza have found a more esoteric use for it. Using zipped files, they can identify the authors of documents and reconstruct the family trees of languages.

The secret lies in the science of information theory, invented by Claude Shannon in the 1940s. Shannon pointed out that the length of the instructions used to encode a string of characters corresponds to the disorder, or "entropy", of that string. A repetitive sequence such as AAAAA contains little entropy. It can be encoded with a brief command: "repeat A five times". On the other hand, a sequence such as QMTWZ can be encoded only with a set of instructions as long as the original sequence.

In practice, the entropy of most writing lies somewhere between these extremes. Zipping programs work by replacing low-entropy data with instructions for reconstructing the replaced data. A good zipping program is able to work out the rules most applicable to a particular document as it goes along.

The length of a zipped file offers a rough-and-ready estimate of its entropy. Comparing the entropy of two texts, however, is slightly more complicated. One method is to feed the zipper some text in one language, then switch the input to a different language. The zipper suddenly finds that the tricks that it has picked up to encode the first language are not much help in encoding the second. In an English-to-French switch, for example, instances of "the" would abruptly become rare, whereas "le", "la" and "les" would crop up all over the place. The result is that the zipped file of such a hybrid document is longer than its monoglot equivalent. The less similar the languages, the more the extra length that is added to the hybrid zipped file. The same, to a lesser degree, is true of documents that have more than one author, and therefore more than one writing style.

Dr Caglioti and his colleagues have created a program that can categorise documents by language or authorship, based on these extra lengths. As he and his colleagues report in *Physical Review Letters*, they first tested it with ten texts apiece from ten official languages of the European Union. Using it, a snippet of text as short as 20 characters can be assigned unerringly to the language it was written in.

As a second test of the program's abilities, they used 52 versions of the document which, according to the "Guinness Book of Records", has been translated into more languages than any other in the world: the Universal Declaration of Human Rights. Forty-nine of these versions were in European languages or dialects. One was in Afrikaans, a South African language derived from Dutch. The other two were Uzbek and Turkish. The program calculated the relative entropies of all possible pairs of these 52 languages. It then used this information to construct a family tree that placed them into clusters.

When completed, this tree had sprouted branches representing all the main language groups in modern Europe: Romance, Celtic, Germanic, Slavic and so on. Moreover, the program was able to recognise the singularity of languages such as Basque and Maltese. It left these isolated, just as linguistic scholars do.

Measurements of relative entropy were enough to unmask anonymous authors, too. The program was fed a set of 89 texts written by nine Italians, including Dante, Machiavelli and Pirandello. Then came the test: by looking for the minimum amount of relative entropy, it tried to guess which of the nine was the author of a 90th text. More than 90% of the time the guess was accurate.

Of course, any self-respecting linguist could have performed these tasks as well as this, if not better. But the mathematicians' invention is still in its infancy, and will soon be set loose on languages that humans

cannot easily learn—protein sequences, for example, or pieces of DNA. It would certainly be interesting if it managed to unmask an anonymous author behind these particular strings of text.

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Schizophrenia

Let the sun shine in

Feb 7th 2002 | SYDNEY
From The Economist print edition

One cause of schizophrenia may be vitamin-deficient mothers

SCHIZOPHRENIA is mysterious. In Europe and North America it is commonest in those born in mid-March. It is more prevalent among people born in cities than those born in the countryside. And the offspring of dark-skinned immigrants to northern countries are three to four times more likely than their pale-skinned *confrères* to suffer from it.

That looks like a disparate collection of facts. But John McGrath, a psychiatrist at the Queensland Centre for Schizophrenia Research in Wacol, Australia, perceives a connection: vitamin D deficiency. At a recent meeting of the International Society for Developmental Neuroscience in Sydney, Dr McGrath and Alan Mackay-Sim, of Griffith University, Brisbane, presented strong evidence for this theory. They fed pregnant rats a diet low in vitamin D and studied the offspring. The results suggest that if a pregnant female rat (and, by extension, possibly a pregnant female human) is deprived of vitamin D, her children are at significant risk of schizophrenia.

The connection between the facts in the first paragraph is that sunlight is an important source of vitamin D. The action of ultra-violet light from the sun on a molecule called 7-dehydrocholesterol, found in the skin, turns it into the vitamin. Winter, city life (with the concomitant shadows cast by tall buildings) and dark skin in dark climates all reduce this action. The connection with schizophrenia is that recent work has found receptors for vitamin D in areas of the developing brain—including regions affected in the disease. The vitamin also appears to trigger the production of a protein called nerve growth factor, which directs the development of nerve cells and promotes their long-term survival.

You cannot, of course, put a rat on a couch and ask it about its hallucinations. Instead, researchers use a test called pre-pulse inhibition, or PPI. When a healthy individual, whether rat or human, is exposed to a quiet pulse of sound before a loud pulse, its tendency to be startled by the louder one is reduced. Human schizophrenics, and rats bred to act as “models” of schizophrenia, do not show this reduced tendency to be startled. Neither did the offspring of vitamin-D-deprived rats. Dr McGrath and Dr Mackay-Sim also found enlargement of the brain's ventricles (fluid-filled cavities) in these rats, as well as thinning of the cortex. Both of these anatomical changes are seen in human schizophrenics too.

The rats' genes were also affected. The use of gene microarrays, which measure the activity of lots of genes in a single piece of tissue, showed that genes known to regulate communication between nerve cells, and cell survival, were behaving abnormally. Some of the same genes are known to be disrupted in human schizophrenics.

The upshot is that vitamin D deprivation looks likely to prove a significant factor in schizophrenia. It is certainly not the whole cause. In many, if not all, cases, a genetic predisposition also seems to be involved. And there is evidence that other triggers, such as maternal viral infections, may play a role. But, unlike these, vitamin D deficiency is easily dealt with. As Dr McGrath observes, if standing in the sunshine for a few minutes a day could be shown to offer some protection to a developing fetus, it is surely worth a try.

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The Richard Casement internship

Feb 7th 2002
From The Economist print edition

We invite applications for the 2002 Richard Casement internship. This is for a would-be journalist under 25 to spend three months of the summer on the newspaper, in London, writing about science and technology. Our aim is more to discover writing talent in a science student than scientific aptitude in a budding journalist. Applicants should write a letter introducing themselves, along with an original article of about 600 words which they think could appear in the Science and technology section. They should be prepared to come for an interview in London or New York, this March, at their own expense. Applications must reach us by February 22nd and should be e-mailed to casement@economist.com.

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Nuclear espionage

Trade secrets

Feb 7th 2002
From The Economist print edition

EPA

Charged with betraying his country, Wen Ho Lee was, in the end, found guilty only of misusing his computer

Get article background

IN MARCH 1999 the *New York Times* published a long and sensational article alleging that China, using secrets stolen from the Los Alamos National Laboratory, had made a tremendous leap in developing nuclear weapons. “This is going to be just as bad as the Rosenbergs,” the CIA's head of counterintelligence declared, referring to the Soviet spies executed in 1953 for betraying atomic secrets. The *New York Times* article reported that a joint FBI-Department of Energy team had gone to America's three main weapons-research labs to examine the records of those scientists who had access to the relevant technology. One name leapt out as a possible suspect. The secretary of energy, Bill Richardson, a former congressman with his eye on the vice-presidency, ordered that Wen Ho Lee, a Taiwanese-born American computer scientist working at Los Alamos, be summarily fired.

A Convenient Spy
By Dan Stober and Ian Hoffman

Simon & Schuster; 384 pages; $26

Buy it at
Amazon.com
Amazon.co.uk

My Country Versus Me
By Wen Ho Lee and Helen Zia

Hyperion Books; 332 pages; $23.95

Buy it at
Amazon.com
Amazon.co.uk

The investigation that had fingered Mr Lee was led by Notra Trulock, the intelligence chief at the Department of Energy, who combined the zeal of Inspector Javert with the ability of Inspector Clouseau. He believed that the classified information must have come from a weapons lab. But a subsequent review indicated that the source could have been any one of dozens of contracting companies or literally thousands of individuals. The FBI was unable to obtain any evidence suggesting, let alone proving, that Mr Lee was a spy. It did, however, establish that he had built up a huge unauthorised collection of computer codes for the design and testing of nuclear weapons, and that he had placed them on an open network accessible to the outside world via the Internet.

Mr Lee was indicted on 59 charges, the most serious of which required proof of intent to injure the United States or to aid a foreign country. At his initial hearing, a national laboratory director said the tapes could “change the world's strategic balance”. The court was told that to grant bail would be to “bet your country”. The judge declined the gamble.

For 278 days Mr Lee was held in solitary confinement, handcuffed and shackled whenever he left his cell. In court, the government's case slowly collapsed. Harold Agnew, a nuclear-weapons adviser to five presidents, said the tapes would be of little or no value to China. FBI testimony was proved false, raising

the question of whether the agent in question was deliberately perjurious or merely incompetent. The case became laughable when the government identified Hungary, Switzerland and Australia as countries Mr Lee had sought to aid. Their grounds for suspicion? Mr Lee may have inquired about getting a new job in those countries.

To save face, the government negotiated an agreement. Mr Lee pleaded guilty to a single count of using an unsecured computer to download a classified document. The sentence was cancelled out by the time he had already served. In a remarkable scene, the judge apologised to Mr Lee. “I believe you were terribly wronged,” he said. “The top decision-makers in the executive branch...have embarrassed our entire nation.”

Without interviewing Mr Lee, Dan Stober and Ian Hoffman have produced a lucid, gripping and revealing account of these events in “A Convenient Spy”. By contrast, Mr Lee's own attempt at self-vindication, “My Country Versus Me”, is badly written, sanctimonious and dull. It is likely, as he repeatedly points out, that if he had not been born in Asia he would not have been indicted. It is also likely that, but for his lies to the FBI on a separate matter in the 1980s, and his egregious security violation in downloading the computer codes, he would not have been indicted either. He glides over these inconvenient facts.

Mr Lee's persecution ought to serve as a cautionary tale of what can occur when fear, race, incompetence and politics intersect with the demands of national security and the criminal law.

A Convenient Spy.
By Dan Stober and Ian Hoffman.
Simon & Schuster; 384 pages; $26

My Country Versus Me.
By Wen Ho Lee with Helen Zia.
Hyperion Books; 332 pages; $23.95

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About sponsorship

American intellectuals

The new phrenology

Feb 7th 2002
From The Economist print edition

“I'M NOT a donkey, and I don't have a field.” So scoffed Max Weber, a great German social thinker, when a faculty non-entity criticised him for writing outside his discipline. The academic division of labour has come on apace since Weber's day (he died in 1920), and hardly a year has passed when someone from the cultural-decline crowd did not decry the narrowing of scholarship and bemoan what they took for its consequence: the death of the free-ranging intellectual.

Public Intellectuals: A Study of Decline
By Richard A. Posner

Harvard University Press; 448 pages; $29.95 and £20.50

Buy it at
Amazon.com
Amazon.co.uk

This concern is not foolish. Who does not wish that the worlds and sub-worlds of science, public affairs and humanities could better talk to one another? Who does not applaud those valuable souls who can move between these worlds with even a hint of grace or plausibility?

Richard Posner, an American federal-appeals judge, law professor and prolific author, puts a new spin on these old anxieties. The trouble with the (mainly American) intellectuals that preoccupy him is not, in his view, that they are dying, but that they are not any good.

He starts off by ruling out what most of us would take as archetypal intellectuals: scientists who explain science to lay people (eg, Steven Weinberg), philosophers with an influential vision of society (eg, John Rawls or Robert Nozick) and literary intellectuals of high Bohemia (eg, Susan Sontag). No, his public intellectuals are really pundits: people who opine about issues of the day on television or in newspaper columns. On the theory that if it's real it must be countable, he ranks what he calls the top 100 on the basis of scholarly citations, media mentions and web hits.

Though some of his pundits (such as Henry Kissinger) have escaped from government, most are moonlighters from universities or think-tanks. As scholars, he tells us, they know much about little; as media egg-heads, they must talk about almost anything. Naturally, they fall on their faces: their stock-in-trade is prediction and some of their forecasts (he doesn't say what proportion) turn out to be wrong.

There are, he adds, too many of them. The supply of commentators outruns demand, and the quality of comment is therefore falling. To improve things, he suggests that public intellectuals should pay more attention to social (particularly economic) realities, spare us their value judgments and post their columns on university websites (where colleagues will supposedly spot and correct their errors).

What are we to make of this extraordinary construction, with its artificial-vanilla-flavour assumptions? Mr Posner was a founder of the law-and-economics movement, an influential view of law which, crudely, recommends economic efficiency as the test of fair allocation. Yet since writing a law-and-economics textbook he has wandered ever farther afield.

Like Mr Posner himself, “Public Intellectuals” is both brilliant and maddening. His knowledge and interests are wide. He is, in a sense, a classic intellectual. His topic, the health of public debate, matters. A dry, factual take on America's commentariat is—or would have been—welcome. But he is here too partisan, too hurried and too driven by the conclusions he wants to reach. In the end, the only intellectuals he does not scorn, you feel, are those who share his reductive and utilitarian outlook. Being a serious intellectual is harder than it looks. That is Mr Posner's point. But need he have illustrated it with this book?

Public Intellectuals: A Study of Decline.
By Richard A. Posner.
Harvard University Press; 448 pages; $29.95 and £20.50

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About sponsorship

Modern Italy

Turn on, tune out

Feb 7th 2002
From The Economist print edition

BY BECOMING more European and more middle-class, Italy ceased to be a country where everything in politics was automatically defined by left and right. Silvio Berlusconi's was less a victory of the classic right than a victory of prosperity and individualism in a country where television, taxes and complaints about bureaucracy are the public language of the day. Paul Ginsborg, a British historian of contemporary Italy, acknowledges these shifts in his survey of the last two decades. In his celebrated earlier book, “A History of Contemporary Italy: Society and Politics, 1943-1988”, the old categories of left and right still applied. What has changed?

Italy and its Discontents: 1980-2001
By Paul Ginsborg

Allen Lane, The Penguin Press; 544 pages; £25

Buy it at
Amazon.co.uk

As before, the new book builds impressively upwards from the economy and society. It is rich in information on marriage and family patterns, on persisting regional disparities, on the decline of religion, on the practices of the civil service and the role of football. It includes a detailed 28-page statistical appendix comparing Italy with its European neighbours.

Italy's first economic miracle after the second world war transformed it into a modern industrial society. Its second, which began in the 1980s, completed its transformation into a post-industrial service economy. Italy is no longer a nation of peasants and workers, Catholics and communists. It is an urban and secularised middle-class society in which 60% of all employees work in the service sector.

A danger with writing any kind of contemporary history is not knowing the next chapter. On recent Italian politics, Mr Ginsborg is inevitably more tentative. He is excellent on the fight against the Mafia and on the weaknesses of Italy's public administration. Indeed, as a brisk chronicle of events, the political chapters themselves are hard to fault. But it would have been good to read in depth why the left lost to Mr Berlusconi in 2001. It was not, Mr Ginsborg tells us, just money and television: the right was more in touch with voters. Evidently. But that begs further questions. Exactly what impact did the collapse of the Soviet block have on communist voters? Just why could the post-communists not unite the left? Perhaps Mr Ginsborg lets the left off too lightly for singing from an old hymn sheet.

This is not to say Mr Ginsborg makes no connection between society and politics. Indeed, he calls his book “an extended argument about democracy”. Broadly, he fears that public morality and civic engagement have not kept pace with economic growth. A big threat to healthy politics, he thinks, comes from the mass media, particularly television. Against this, he treats the growth of education as a more hopeful trend. Yet arguably he underplays how far the expansion of schooling has come at the cost of educational standards.

These are points of political interpretation on which people can reasonably differ. All in all, as a social and economic portrait, “Italy and its Discontents” is a *tour de force*. Anyone concerned about the condition of the country will find it packed with material to think about and argue over.

Italy and its Discontents: 1980-2001.
By Paul Ginsborg.
Allen Lane, The Penguin Press; 544 pages; £25

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New fiction

Stories from science

Feb 7th 2002
From The Economist print edition

ANDREA BARRETT grew up by the ocean on Cape Cod. When she realised she would never be Linnaeus or Mendel, or even an ocean-going naturalist like Darwin, she turned her back on biology and became a storyteller instead. But biology's loss was literature's gain, as her latest collection of six stories proves.

Servants of the Map
By Andrea Barrett

Norton; 270 pages; $24.95. To be published in Britain by Flamingo in June

Buy it at
Amazon.com
Amazon.co.uk

Ms Barrett has made the waters that swirl between a love of science and the science of love her special domain. In a previous collection, “Ship Fever”, two Englishwomen set out to prove that, contrary to the great Linnaeus's belief, swallows do not hibernate underwater. The year is 1764, and the women must experiment in secret if they are not to be dismissed by the scientific establishment. When, at the end of the story, the two women disappear, you are left hoping against hope that they have been stolen away by love.

In “Servants of the Map” Ms Barrett continues to explore loneliness and isolation, but with an eye on the comic discrepancies among different people's perceptions. In “The Forest”, the inevitable gap of perspectives between an illustrious Polish scientist grown nostalgic with age and an uncertain young woman who yearns to break free from her past leads to a walk in the woods that ends with a twisted ankle and a hilarious escape for both heroes.

But it is the title story, selected for inclusion in last year's “Best American Short Stories”, which confirms how deserving Ms Barrett is to be ranked with Alice Munro and the other great North American storytellers of the moment. An English mapmaker, Max Vigne, leaves behind his wife and a child he has never seen to work as a topographical surveyor in 1860s India. In the western Himalayas he struggles to assuage his guilt and loneliness, writing letters home that serve only to chronicle the distance that is growing between man and wife. While he avoids the crude comforts sought by the other Englishmen around him, he comes to realise that in his unquenchable desire to be a botanist he must put off his return home, thus exposing himself to yet more guilt and his poor family to a still deeper loneliness.

It is the precision of Ms Barrett's words that makes her stories so rewarding, and the intelligence with which she creates bonds between characters from an age so different from our own that makes reading her such a joy.

Servants of the Map.
By Andrea Barrett.
Norton; 270 pages; $24.95. To be published in Britain by Flamingo in June

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Jazz lives

Yours if you can hear it

Feb 7th 2002
From The Economist print edition

FOR Gene Lees, the experience of jazz is inseparable from the experience of race. As a Canadian teenager in the early 1940s he was overwhelmed by a chance encounter with the Duke Ellington band. He was equally amazed by the music produced by this imposing group of stylish, urbane black performers, so different from the caricatures he had seen in Hollywood films. His budding passion for jazz inspired a career as a critic.

You Can't Steal a Gift: Dizzy, Clark, Milt, and Nat
By Gene Lees

Yale University Press; 269 pages; $27.95 and £19.95

Buy it at
Amazon.com
Amazon.co.uk

But none of this prepared him for his first exposure to the vicious racism of the American South. There he learned that neither artistic mastery nor simple humanity could protect blacks from indignity and physical harm, and the shock and outrage of that discovery have remained with him to this day.

Nonetheless, most of this warm, illuminating book is a homage to four great black jazz musicians. They seem to have been much less concerned about racism than Mr Lees, who is as astonished by their tolerance and wisdom as he is by their artistic achievement.

The special flavour of these mini-biographies, as Mr Lees calls them, comes from his personal acquaintance with his subjects. He draws heavily on their conversations over many years. Dizzy Gillespie, a trumpeter who was one of the founders of modern jazz, comes across not only as a brilliant musician but as a witty and humane man, able to charm people (including Mr Lees's mother) with no interest in jazz.

Just as attractive is Milt Hinton, a bassist who won the greatest respect in his profession and played until he was almost 90, never letting racial prejudice distract him from his devotion to his instrument. Similarly, Clark Terry, a trumpeter, was so determined to become a musician that, growing up in a poor part of St Louis, he made his first horn out of a piece of hose pipe. Now over 80, he has spent much of his later career educating young musicians—and having to combat the phenomenon of reverse racism, the prejudice some young black players have against whites.

Indeed, Mr Lees's book casts a good deal of light on the complexities of racial attitudes, well illustrated by the career of Nat King Cole, a distinguished singer-pianist who was once attacked on stage by white hoodlums, but who was also accused by black critics of being insufficiently militant.

In the end, though, it is the great equality of jazz that shines through these pages. The title comes from Dizzy Gillespie's response to a talented white saxophonist who feared that in playing jazz he was "stealing" black people's music. Mr Gillespie assured him that the music was for everybody. "You can't steal a gift," he said. "If you can hear it, you can have it." And Mr Lees's telling of the lives of these four exemplary musicians is a gift to the reader as well.

You Can't Steal a Gift: Dizzy, Clark, Milt, and Nat.
By Gene Lees.
Yale University Press; 269 pages; $27.95 and £19.95

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About sponsorship

War photography

Feb 7th 2002
From The Economist print edition

A Cambodian guerrilla, injured by American bombing, is brought to a makeshift Viet Cong operating theatre in a mangrove swamp on the Ca Mau Peninsula. This is just one of the many arresting images on display in “Another Vietnam: Pictures of the War from the Other Side”, an exhibition at the International Centre of Photography in New York (until March 17th).

Doug Niven, a photographer formerly with Agence France-Presse, made more than a dozen trips to Vietnam in the 1990s in search of pictures taken by North Vietnamese and Viet Cong photographers during the war. He unearthed thousands of images, often processed at night using river water, together with countless rolls of long-forgotten, undeveloped film. “Another Vietnam” documents all aspects of the North Vietnamese war effort, from family life to combat and liberation. A book of the same title, edited by Mr Niven and Chris Riley, is published by National Geographic Books ($50).

National Geographic Society

Another Vietnam
Edited by Doug Niven and Chris Riley

National Geographic Books; 240 pages; $50

Buy it at
Amazon.com
Amazon.co.uk

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About sponsorship

Feral children

Call of the wild

Feb 7th 2002
From The Economist print edition

“THE story of Kaspar Hauser”, wrote the Duchess of Cleveland in 1893, “is both curious and instructive. It shows on how commonplace and unpromising a foundation a myth of European celebrity may rest.” Kaspar Hauser is perhaps the most famous wild child of all time. An odd-looking young man, found wandering around the outskirts of Nuremberg in 1828, he had, it turned out, spent his childhood alone in a dungeon. The unfortunate youth was soon taken into the care of Lord Stanhope, only to die in suspicious circumstances five years later.

Savage Girls and Wild Boys: A History of Feral Children
By Michael Newton

Faber and Faber; 284 pages; £12.99

Buy it at
Amazon.co.uk

Michael Newton's book offers a brisk survey of wild children through the ages, from Romulus and Remus, the mythical founders of ancient Rome, to Ivan Mishukov, a Russian orphan who actually did live with a pack of wild dogs on the streets of Moscow in the late 1990s. Along the way Mr Newton revisits a number of perennial nature-nurture questions, particularly about speech and language. Are children genetically programmed to learn language, or is it something they must be taught? Is there a point in a child's development after which language cannot be learned? How important are social factors in the acquisition of language?

Mr Newton's most disturbing chapter concerns a girl who became known as Genie. Genie was not a wild child as such. She was not raised by animals, or at least not the quadruped kind. She lived in a house in a suburb of Los Angeles. For 13 years she was locked in a dark room, either bound to a chair or tied into a sleeping bag. Her father communicated with her only in dog-like barks. If she cried, she was savagely beaten. Even once she had been released, in 1970, from this living hell, she never fully learned to speak or to relate to others, and remained lost in a private world of unimaginable darkness and terror. Those who studied her concluded that the crucial factor behind her lack of linguistic development was the late age at which she began to learn to speak.

Mr Newton writes perceptively and sympathetically about Genie's case. Yet some of his generalisations—that wild children may be thought of as screens on to which successive generations have “projected their own preoccupations”, or that they tell us something about “our continuing relationship with the savage image of ourselves”—seem utterly beside the point. Such stories as Genie's are impossible either to romanticise or coolly to accept as lessons. They are certainly, as the Duchess of Cleveland observed, curious. But the spectacle of suffering they present is not always instructive.

Savage Girls and Wild Boys: A History of Feral Children.
By Michael Newton.
Faber and Faber; 284 pages; £12.99

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About sponsorship

European bestsellers

What the world is reading

Feb 7th 2002
From The Economist print edition

Tolkien, tiramisu and the twin towers

CELEBRITY cooks have stormed the British top ten, while J.R.R. Tolkien's hobbits are popping up all over Europe. In the Netherlands they jostle with a popular comedian and a former diplomat; in Spain they are outselling blockbuster thrillers and romance novels. The Italians, meanwhile, have maintained a healthy interest in worldly affairs. The current list includes light and weighty, contemporary and historical titles.Oriana Fallaci has broken a decade-long silence to write on last year's terroristattacks, while Bruno Vespa considers their implications for domestic politics.

Bestsellers

	BRITAIN	NETHERLANDS
1	**Delia's How to Cook: Book 3** *by Delia Smith* Celebrity cook's recipes	**Bezeten van mij** *by Nicci French* Psychological thriller
2	**Fame Fatale** *by Wendy Holden* Making the A-list	**De laatste man** *by David Baldacci* Political thriller
3	**Happy Days with the Naked Chef** *by Jamie Oliver* Another celebrity cook's recipes	**Zes sterren** *by Joost Zwagerman* Family response to a failed suicide attempt
4	**Resurrection Men** *by Ian Rankin* Latest Inspector Rebus mystery	**De ontdekking van de hemel** *by Harry Mulisch* Meeting of two different minds
5	**Delia's How to Cook: Book 2** *by Delia Smith* Celebrity cook's recipes	**Allemaal gelogen** *by F. Springer* Collection of short stories by a former diplomat
6	**Billy** *by Pamela Stephenson* Biography of Billy Connolly by his wife	**De rookspringer** *by Nicholas Evans* Fighting some fires, kindling others
7	**Delia's How to Cook: Book 1** *by Delia Smith* Celebrity cook's recipes	**Het zesde zintuig** *by Marianne Fredriksson* Novel of two paranormally gifted children
8	**Bored of the Rings** *by the Harvard Lampoon* Timely reissue of 1960s parody	**Gloed** *by Sandor Marai* Two friends reunited after 41 years
9	**A Man Named Dave** *by Dave Pelzer* Third volume of autobiography	**Ledereen is in de war** *by Youp van 't Hek* Compilation from top comedian and journalist
10	**Eat Yourself Slim** *by Rosemary Conley* Diet plan	**In de ban van de ring** *by J.R.R. Tolkien* Classic fantasy

	ITALY	SPAIN
1	**La rabbia e l'orgoglio** *by Oriana Fallaci* Famous journalist on September 11th	**La cancion de Dorotea** *by Rosa Regas* Rural family drama
2	**Il signore degli anelli** *by J.R.R Tolkien* Classic fantasy	**Soldados de Salamina** *by Javier Cercas* Controversial novel of Spanish civil war
3	**Harry Potter e la pietra filosofale** *by J.K. Rowling* More Harry and more wizardry	**Baudolino** *by Umberto Eco* Medieval fiction
4	**Ritratto in seppia** *by Isabel Allende* Family drama	**El arpista ciego** *by Terenci Moix* Making music for the Pharaohs
5	**La gazza ladra** *by Ken Follett* Resistance thriller	**El señor de los anillos** *by J.R.R. Tolkien* Classic fantasy
6	**Il re di Girgenti** *by Andrea Camilleri* Novel of peasants' revolt in Sicily in 1718	**Harry Potter y la piedra filosofal** *by J.K. Rowling* More Harry and more wizardry
7	**Saltatempo** *by Stefano Benni* Quirky rite-of-passage novel	**Lo que esta en mi corazon** *by Marcela Serrano* Journalist caught up in Zapatista revolution
8	**Pappagalli verdi** *by Gino Strada* Military doctor's experiences working for the UN	**La vida sexual de Catherine M.** *by Catherine Millet* Art expert describes her sex life
9	**Il cammino di Santiago** *by Paulo Coelho* Quest for wisdom	**Los Borgia** *by Mario Puzo* Novel of the original crime family
10	**La scossa** *by Bruno Vespa* What September 11th did to the Left	**El ultimo caton** *by Matilde Asensi* Unearthing Vatican secrets

Descriptions by *The Economist*
Sources: Whitaker BookTrack, Libris, Internet Bookshop Italia, *El Cultural*

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About sponsorship

Hildegard Knef

Feb 7th 2002
From The Economist print edition

Hildegard Knef, actress and writer, died on February 1st, aged 76

AP

WHEN Hildegard Knef started out as an actress Germany was still ruled by Hitler. She recalled that at her first audition she had to pretend to be “a joyous German maid in the summer wind”. Josef Goebbels, Hitler's propaganda chief, who had a liking for pretty young women, invited her to dinner, privately. She says in her autobiography “The Gift Horse” that she avoided Goebbels's attentions; she was anyway much too smitten by a film producer who promised to make her a star, although his views were not much different from those of Goebbels. He believed in “the master race, in the mission, in Germany's vocation, in those called upon to govern, to dictate”. He told Miss Knef he despised the “small-minded, the greedy who called themselves democrats and communists”.

In her book Miss Knef takes care not to endorse these incorrect views. She was 18 at the time of her adventure and so impressionable that she dressed as a soldier and followed her lover to the front when he fought against the Russians as they approached Berlin (and was killed). She could not argue with him, she said. She sought to explain to Germans of a later generation what it was like to be a young person in the time of Hitler, with “no idea what it was like before”.

Most Germans saw her point. Like Germany itself, they said, she had successfully bridged the period between dictatorship and democracy; from being a golden, blue-eyed symbol of Aryanism to becoming the best-known German actress of the post-war period, the star of more than 50 films; admired more even than Marlene Dietrich, who was never quite forgiven in Germany for supporting the Americans in the war. The German chancellor, Gerhard Schröder, said Miss Knef had earned her place in history. The mayor of Berlin said she was the voice of his city.

The sin of nudity

Few of Hildegard Knef's films are memorable. They are unlikely to be revived as masterpieces on minority television channels. They were competently made, gave pleasure and all but a few were then forgotten. “The Murderers Are Among Us” (1946), in which she played the former inmate of a concentration camp returning home, has archive interest because it was the first film made in Germany after the war. “The Sinner” (1950) was attacked by church leaders because Miss Knef briefly exposed a breast, and was consequently very successful commercially.

Hollywood summoned her, described her as the new Garbo, and unsuccessfully tried to remake her in its own image. She refused to change her name to Gilda Christian, but agreed under pressure to spell her name Neff. She refused to say she was Austrian rather than German. The Austrians had Nazis, too, she told a publicity man. “Nobody knows that here,” he said.

She described her first meeting with David Selznick, a producer.

> “You're an interesting girl,” he said, standing directly before me, “a pretty, interesting girl. Do you like me a little?”
>
> “I don't know you very well,” I said idiotically, near panic.
>
> “That could be changed.”

> I stared at the wide neck, the tight smile, a smile that meant power. “I don't know any German girls,” he said and tugged at my jacket. Two buttons sprang away like flat stones that one flips over water. The man, smelling of mouthwash and after-shave, was more menacing than the Russians.

Hildegard Knef wrote well. She also sang well. In “The Snows of Kilimanjaro” (1952) she sang three songs by Cole Porter, who was so captivated by her rendering of “You Do Something to Me” that he offered her a leading role in a Broadway musical, “Silk Stockings”, which ran for years.

Her singing, if not her films, may be remembered. Some say that she did not really sing, that her husky voice bordered more on speaking. Ella Fitzgerald said she was “the greatest singer in the world without a voice”. Whatever it was, Miss Knef created a new style of putting over a song that has been much copied.

Critics said she diffused her talents too much. She could have acted in better films; in her early days she had worked in the theatre and showed promise in classic roles. She could have written more. “But success is greatly overrated,” she said. “Failure, too, but it gives you a whole lot more to talk about.” She talked about her two divorces, of a savaging in the German press for “selling out to Hollywood”; and in the American press for her wartime experiences. She spoke of her struggle against cancer and the difficulty of giving up smoking.

German doctors were among the first to spot a link between smoking and cancer, their findings stretching back to the Hitler period. “I smoked all my life,” Miss Knef said. Sometimes 50 or perhaps 60 a day: she never counted. Her health-minded fans counted at least five films in which she was seductively smoking. She tried to appease them by giving up smoking, frequently, and, as she said with a wan smile, “suffering for it”. In a second book about her life, “The Verdict”, she wrote of her fears about cancer. Probably smoking contributed to her death. She put up a long struggle against a lung infection. She said that the only thing she ever really learned in her life was ways to survive.

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Overview

Feb 7th 2002
From The Economist print edition

American employment fell again in January, albeit at a slower pace. However, the unemployment rate dropped to 5.6%, down from 5.8% in December, as discouraged job-seekers dropped out of the labour force.

America's productivity has held up well during the recession. Output per hour in the non-farm business sector rose at an annual rate of 3.5% in the fourth quarter of 2001, leaving productivity 1.6% higher than a year earlier. This is the best productivity performance in any recession in the past 50 years.

Japan's Nikkei 225 average plunged by 5% on mounting concerns about the country's creaking banking system. The Nikkei fell below America's Dow Jones Industrial Average for the first time since 1957.

European businessmen are perking up. The European Commission's euro-area business-climate indicator rose in January for the first time since December 2000. In December 2001 it had hit a five-and-a-half-year low.

German unemployment rose above the politically sensitive 4m mark in January. The seasonally adjusted jobless total remained a whisker below 4m, but it increased to 9.6% of the labour force. The **euro area's** unemployment rate held steady at 8.5% in December.

Gold prices have jumped by almost 10% over the past week, to a two-year high of $305 an ounce. Nervous investors, especially in Japan, have been shifting money out of equities into gold.

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Output, demand and jobs

Feb 7th 2002
From The Economist print edition

% change at annual rate

	GDP			The Economist poll GDP forecasts		Industrial production		Retail sales (volume)		Unemployment % rate		
	1 qtr	1 year		2001	2002	latest		latest		latest		year ago
Australia	+ 4.6	+ 2.5	Q3	+ 2.2	+ 3.3	+ 0.4	Q3	+ 4.8	Q4	6.7	Dec	6.3
Austria	– 0.3	+ 0.9	Q3	+ 1.0	+ 1.0	– 5.5	Nov	nil	Oct	4.2	Dec	3.6
Belgium	+ 0.1	+ 0.6	Q3	+ 1.1	+ 1.0	– 9.3	Nov*	– 2.5	Oct	10.8	Dec*	10.6
Britain	+ 1.0	+ 1.9	Q4	+ 2.4	+ 1.9	– 4.6	Dec	+ 5.7	Dec	5.1	Nov†	5.3
Canada	– 0.8	+ 0.8	Q3	+ 1.4	+ 1.4	– 6.0	Nov	+ 2.1	Oct	8.0	Dec	6.8
Denmark	+ 3.5	+ 1.4	Q3	+ 1.1	+ 1.3	+ 0.8	Nov	+ 0.9	Oct	5.0	Nov	5.5
France	+ 1.9	+ 2.0	Q3	+ 2.1	+ 1.4	– 0.9	Nov	– 0.8	Nov	9.0	Dec	9.0
Germany	– 0.6	+ 0.3	Q3	+ 0.7	+ 0.7	– 4.5	Nov	– 0.4	Nov	9.6	Jan**	9.3
Italy	+ 0.6	+ 1.9	Q3	+ 1.8	+ 1.1	– 5.8	Nov	– 0.9	Nov	9.3	Oct	10.0
Japan	– 2.2	– 0.5	Q3	– 0.4	– 1.3	–14.9	Dec	– 1.9	Nov	5.6	Dec	4.9
Netherlands	– 1.4	+ 0.4	Q3	+ 0.9	+ 1.1	– 6.2	Dec	+ 3.2	Oct	1.9	Dec§	2.6
Spain	+ 1.1	+ 2.8	Q3	+ 2.6	+ 1.8	– 4.5	Dec	na		12.9	Dec	13.5
Sweden	+ 0.2	+ 0.4	Q3	+ 1.2	+ 1.4	– 5.1	Nov	+ 2.6	Nov	3.6	Dec*	3.7
Switzerland	+ 0.1	+ 0.8	Q3	+ 1.4	+ 0.9	+ 1.9	Q3*	+ 4.3	Nov	2.4	Dec*	1.9
United States	+ 0.2	+ 0.1	Q4	+ 1.1	+ 1.2	– 5.8	Dec	+ 6.5	Dec	5.6	Jan	4.2
Euro area	+ 0.4	+ 1.4	Q3	+ 1.5	+ 1.1	– 4.3	Nov	+ 1.3	Nov	8.5	Dec	8.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 5.0	nil	Q3	na	na	– 3.1	Dec	+ 5.0	Oct	8.1	Dec*	8.3
Greece	na	+ 4.4	Q3	na	na	+ 0.7	Nov*	+ 4.1	Oct	na		na
Iceland	na	+ 3.6	2000	na	na	+ 2.5	2000	na		1.6	Nov	1.2
Ireland	na	+ 9.2	Q2	na	na	– 8.0	Nov	+ 3.5	Nov	4.1	Jan	3.6
Luxembourg	na	+ 8.5	2000	na	na	+ 6.1	Nov	+10.0	Oct	2.7	Nov	2.6
New Zealand	+ 2.8	+ 2.1	Q3	na	na	+ 2.6	Q3*	+ 6.3	Q3	5.2	Q3	5.8
Norway	+ 3.8	+ 1.9	Q3	na	na	– 2.5	Nov	+ 2.2	Dec	3.3	Q4	3.1
Portugal	– 1.0	+ 1.3	Q3	na	na	+ 2.9	Nov	+ 4.9	Nov	4.0	Q3	4.0

*Not seasonally adjusted. †Sep-Nov; claimant count rate 3.2% in Dec. §Oct-Dec. **EU harmonised rate 8.1% in Jan.

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Prices and wages

Feb 7th 2002
From The Economist print edition

% change at annual rate

	Consumer prices* latest		Consumer prices* year ago	The Economist poll consumer prices forecast 2001	The Economist poll consumer prices forecast 2002	Producer prices* latest		Producer prices* year ago	Wages/earnings latest		Wages/earnings year ago
Australia	+ 3.1	Q4	+ 5.8	+ 4.1	+ 2.4	– 0.7	Q4	+ 8.4	+ 4.0	Q3	+ 6.5
Austria	+ 1.9	Dec	+ 2.6	+ 2.6	+ 1.5	– 0.4	Jan	+ 3.2	+ 2.7	Dec	+ 2.2
Belgium	+ 2.9	Jan	+ 2.2	+ 2.5	+ 1.5	– 3.6	Nov	+10.2	+ 3.1	Q4	+ 1.6
Britain	+ 0.7	Dec	+ 2.9	+ 1.9	+ 1.9	– 1.2	Dec	+ 2.3	+ 4.2	Nov	+ 4.2
Canada	+ 0.7	Dec	+ 3.2	+ 2.6	+ 1.2	– 2.3	Dec	+ 2.4	+ 2.5	Nov	+ 2.6
Denmark	+ 2.2	Dec	+ 2.4	+ 2.3	+ 1.8	+ 0.4	Dec	+ 3.9	+ 4.3	Q3	+ 3.8
France	+ 1.4	Dec	+ 1.6	+ 1.7	+ 1.1	– 1.6	Dec	+ 4.7	+ 4.1	Q3	+ 5.3
Germany	+ 1.7	Dec	+ 2.2	+ 2.4	+ 1.2	– 1.5	Dec	+ 5.1	+ 1.9	Nov	+ 1.8
Italy	+ 2.4	Jan	+ 3.0	+ 2.5	+ 1.8	– 1.3	Dec	+ 6.2	+ 2.8	Dec*	+ 1.7
Japan	– 1.2	Dec	– 0.4	– 0.7	– 0.9	– 0.8	Dec	+ 1.1	– 0.5	Dec*	+ 1.0
Netherlands	+ 4.4	Dec	+ 2.9	+ 4.8	+ 2.4	– 2.2	Dec	+ 7.6	+ 4.6	Nov	+ 3.3
Spain	+ 2.7	Dec	+ 4.0	+ 3.6	+ 2.3	– 0.8	Dec	+ 5.0	+ 3.6	Q3†	na
Sweden	+ 2.9	Dec	+ 1.4	+ 2.6	+ 2.0	– 0.8	Dec	+ 3.7	+ 3.0	Nov*	+ 2.2
Switzerland	+ 0.5	Jan	+ 1.3	+ 1.0	+ 0.6	– 1.9	Dec	+ 2.2	+ 1.3	2000	+ 0.3
United States	+ 1.6	Dec	+ 3.4	+ 2.9	+ 1.4	– 1.8	Dec	+ 3.6	+ 4.0	Jan	+ 3.9
Euro area	+ 2.5	Jan	+ 2.4	+ 2.6	+ 1.5	– 1.1	Dec	+ 5.4	+ 2.9	Q3	+ 2.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.6	Dec	+ 3.5	na	na	– 2.7	Dec	+ 5.9	+ 4.5	Q3*	+ 4.9
Greece	+ 3.0	Dec	+ 3.9	na	na	+ 0.2	Nov	+ 9.0	na		na
Iceland	+ 9.4	Jan	+ 3.5	na	na	+11.4	Jan	+ 4.4	+ 9.6	Dec	+ 7.6
Ireland	+ 4.2	Dec	+ 5.9	na	na	nil	Dec	+ 4.5	+ 8.7	Q3*	+ 7.4
Luxembourg	+ 1.7	Dec	+ 3.5	na	na	– 1.1	Nov	+ 5.0	+ 3.4	Aug*	+ 7.0
New Zealand	+ 1.7	Q4	+ 4.0	na	na	+ 6.2	Q3	+ 8.4	+ 2.2	Q4	+ 1.6
Norway	+ 2.1	Dec	+ 3.0	na	na	–14.1	Dec	+ 9.0	+ 4.6	Q3*	+ 4.2
Portugal	+ 3.7	Dec	+ 3.9	na	na	– 9.4	Dec	+13.5	+ 2.4	Apr*	na

*Not seasonally adjusted. †New series.

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Economic forecasts

Feb 7th 2002
From The Economist print edition

February averages (previous month's, if changed)

	Real GDP, % change Low/high range		Real GDP, % change average		Consumer prices % increase		Current account % of GDP	
	2001	2002	2001	2002	2001	2002	2001	2002
Australia	1.5/2.5	2.2/4.1	2.2 (2.1)	3.3 (3.2)	4.1 (4.2)	2.4	−2.2(−2.3)	−2.9 (−2.8)
Austria	−0.8/1.4	0.2/1.5	1.0 (1.1)	1.0	2.6 (2.5)	1.5 (1.4)	−2.3(−2.5)	−2.0 (−2.2)
Belgium	0.4/1.6	0.1/1.6	1.1 (1.2)	1.0	2.5	1.5	4.0 (3.9)	4.3 (4.2)
Britain	2.2/3.0	1.4/2.4	2.4 (2.2)	1.9 (1.8)	1.9	1.9	−1.5(−1.7)	−2.1 (−2.2)
Canada	1.2/1.6	0.6/2.4	1.4	1.4 (1.2)	2.6	1.2 (1.5)	2.8 (2.7)	1.9 (1.7)
Denmark	0.4/1.5	0.6/1.8	1.1	1.3	2.3	1.8 (1.9)	2.8 (2.5)	2.3 (2.1)
France	1.9/2.4	0.9/2.0	2.1 (2.0)	1.4 (1.3)	1.7	1.1	1.6	1.5
Germany	0.5/0.8	0.4/0.9	0.7	0.7 (0.6)	2.4	1.2 (1.1)	−0.4(−0.6)	−0.1 (−0.3)
Italy	1.6/1.9	0.6/1.6	1.8	1.1 (1.0)	2.5 (2.7)	1.8 (1.6)	−0.2	0.2
Japan	−0.8/−0.1	−2.3/−0.2	−0.4	−1.3 (−1.2)	−0.7	−0.9 (−1.0)	2.1 (2.0)	2.2 (2.0)
Netherlands	0.8/1.2	0.6/1.8	0.9	1.1 (1.0)	4.8	2.4 (2.2)	3.6 (3.7)	3.7 (3.9)
Spain	2.5/2.7	1.4/2.5	2.6	1.8	3.6	2.3 (2.2)	−2.5	−2.3
Sweden	1.0/1.6	0.9/1.8	1.2 (1.3)	1.4	2.6 (2.5)	2.0 (1.9)	2.6 (2.4)	2.5 (2.3)
Switzerland	1.3/1.6	0.3/1.3	1.4 (1.5)	0.9	1.0	0.6	10.0(10.7)	10.1 (11.1)
United States	0.9/1.1	0.3/1.8	1.1	1.2 (0.7)	2.9	1.4 (1.5)	−4.0(−4.1)	−4.1 (−4.0)
Euro area	1.3/1.6	0.8/1.4	1.5	1.1 (1.0)	2.6	1.5 (1.4)	−0.2	nil (−0.1)

Sources: ABN Amro, Deutsche Bank, Economist Intelligence Unit, Goldman Sachs, HSBC Securities, KBC Bank, Merrill Lynch, J.P. Morgan Chase, Morgan Stanley Dean Witter, Nordbanken, Decision Economics, Royal Bank of Canada, Schroder Salomon Smith Barney, Scotiabank, Shinsei Bank, UBS Warburg

Each month *The Economist* surveys a group of forecasters and calculates the average of their predictions for growth, inflation and current-account balances for 15 countries and the euro area. The table also shows their highest and lowest projections for growth. The previous month's forecasts, where different, are shown in brackets. Following signs that the recession may have ended, our panel has raised its average forecast for America's GDP growth in 2002 to 1.2%, up from 0.7% in January. If correct, this means that America will again outpace the euro area, where GDP is forecast to grow by only 1.1% in 2002. Our most optimistic forecaster is predicting 1.8% growth in America; our gloomiest, only 0.3%. The panel has become more pessimistic about Japan: it now expects its GDP to shrink by 1.3% this year. Australia is tipped to grow by 3.3%.

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Money and interest rates

Feb 7th 2002
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Feb 6th 2002)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+21.8	+14.9	Dec	4.28	5.65	4.65	5.86	5.36	6.73
Britain	+ 7.9	+ 6.7	Dec	4.06	5.75	4.55	4.81	4.71	5.86
Canada	+15.3	+ 4.9	Dec	1.97	5.13	3.15	5.39	5.42	6.88
Denmark	+ 6.6	+ 6.5	Dec	3.68	5.36	4.15	4.98	5.02	7.02
Japan	+13.7	+ 3.4	Dec	0.03	0.41	0.08	1.53	1.44	1.64
Sweden	+ 7.1	+ 6.2	Nov	3.83	4.01	4.66	5.19	4.72	5.37
Switzerland	+ 6.3	+ 4.7	Dec	1.67	3.49	2.52	3.37	3.33	4.54
United States	+ 8.2	+13.5	Dec	1.79	5.19	2.97	4.93	5.19	6.76
Euro area†	+ 5.0	+ 8.0	Dec	3.35	4.65	3.72	4.76	4.69	5.63

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. † Germany for bonds. Benchmarks: US 30-year 5.43%, Japan No.236 1.54%. Central bank rates: US fed funds 1.75%, ECB refinancing 3.25%, BOJ overnight call 0.001%, BOE repo 4.00%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmshörsen, UBS Warburg, DRI-WEFA, Westpac, Thomson Financial Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Feb 7th 2002
From The Economist print edition

1995=100

	Jan 29th	Feb 5th*	% change on one month	% change on one year
Dollar index				
All items	67.2	66.9	- 0.9	- 6.8
Food	68.3	67.6	- 2.4	- 4.1
Industrials				
All	65.7	66.0	+ 1.3	-10.4
Nfa†	64.8	63.5	+ 5.8	- 4.8
Metals	66.5	68.2	- 1.9	-14.4
Sterling index				
All items	75.1	74.4	+ 0.8	- 4.1
Euro index				
All items	102.5	101.4	+ 1.7	- 0.1
Yen index				
All items	95.5	95.3	+ 0.1	+ 8.4
Gold				
$ per oz	278.60	291.95	+ 4.7	+10.9
West Texas Intermediate				
$ per barrel	19.28	20.10	- 3.6	-33.6

* Provisional. † Non-food agriculturals.

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Stockmarkets

Feb 7th 2002
From The Economist print edition

Market indices

	Feb 6th	2001-02 high	2001-02 low	% change on one week	% change on record high	% change on Dec 31st 2000 in local currency	% change on Dec 31st 2000 in $ terms
Australia (All Ordinaries)	3,368.6	3,425.2	2,867.4	- 0.2	- 1.7	+ 6.8	- 2.3
Austria (ATX)	1,190.4	1,245.8	1,014.3	+ 2.2	-31.5	+10.9	+ 2.7
Belgium (Bel 20)	2,738.6	3,030.4	2,322.6	nil	-25.6	- 9.5	-16.2
Britain (FTSE 100)	5,073.8	6,334.5	4,433.7	- 0.3	-26.8	-18.5	-22.8
Canada (Toronto Composite)	7,497.1	9,348.4	6,513.1	- 0.7	-34.2	-16.1	-21.4
Denmark (KBX)	218.9	294.3	197.8	+ 1.0	-27.5	-17.3	-23.1
France (SBF 250)	2,803.9	3,820.2	2,335.3	- 3.0	-36.1	-25.7	-31.2
(CAC 40)	4,273.8	5,998.5	3,652.9	- 3.0	-38.3	-27.9	-33.2
Germany (Xetra DAX)	4,804.4	6,795.1	3,787.2	- 4.9	-40.4	-25.3	-30.9
Italy (BCI)	1,379.4	1,948.4	1,082.9	- 3.3	-36.8	-28.0	-33.4
Japan (Nikkei 225)	9,420.9	14,529.4	9,420.9	- 5.0	-75.8	-31.7	-41.6
(Topix)	922.5	1,441.0	863.4	- 4.4	-68.0	-28.1	-38.5
Netherlands (AEX)	481.6	642.3	396.2	- 2.8	-31.4	-24.5	-30.1
Spain (Madrid SE)	775.2	963.9	648.6	- 3.0	-32.4	-12.0	-18.5
Sweden (Affarsvarlden Gen)	215.5	293.1	177.5	+ 1.8	-46.2	-22.4	-30.9
Switzerland (Swiss Market)	6,105.2	8,135.4	5,110.2	- 1.7	-27.4	-25.0	-28.2
United States (DJIA)	9,653.4	11,337.9	8,235.8	- 1.1	-17.7	-10.5	-10.5
(S&P 500)	1,083.5	1,373.7	965.8	- 2.7	-29.1	-17.9	-17.9
(Nasdaq Comp)	1,812.7	2,859.2	1,423.2	- 5.3	-64.1	-26.6	-26.6
Europe (FTSE Eurotop 300)*	1,192.5	1,545.5	998.9	- 2.3	-30.1	-22.2	-28.0
Euro area (FTSE Ebloc 100)*	1,026.9	1,404.1	843.6	- 3.9	-33.8	-26.2	-31.7
World (MSCI)†	937.0	1,249.2	856.6	- 2.4	-35.3	na	-23.3
World bond market (Salomon)‡	434.7	461.7	420.6	+ 0.5	- 5.5	na	- 2.1

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms. ‡Schroder Salomon Smith Barney World Government Bond Index, total return, in dollar terms.

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Trade, exchange rates and budgets

Feb 7th 2002
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2001	2002	Exchange rate trade-weighted† Feb 6th	year ago	Currency units per $ Feb 6th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2001‡
Australia	+ 2.0	Dec	− 8.5	Q3	− 2.2	− 2.9	73.6	73.8	1.97	1.83	2.78	1.71	1.47	0.1
Austria	− 5.0	Oct	− 4.3	Nov	− 2.3	− 2.0	100.1	100.5	15.8	14.8	22.4	13.8	11.9	nil
Belgium	+ 12.2	Nov	+ 12.4	Sep	+ 4.0	+ 4.3	98.8	99.5	46.4	43.3	65.6	40.3	34.8	nil
Britain	− 41.1	Nov	− 17.7	Q3	− 1.5	− 2.1	106.8	103.7	0.71	0.68	–	0.61	0.53	1.1
Canada	+ 42.5	Nov	+ 23.9	Q3	+ 2.8	+ 1.9	75.6	78.8	1.60	1.51	2.27	1.39	1.20	2.8
Denmark	+ 7.5	Nov	+ 4.8	Nov	+ 2.8	+ 2.3	102.1	102.1	8.55	8.00	12.1	7.43	6.40	2.0
France	+ 2.7	Nov	+ 24.1	Nov	+ 1.6	+ 1.5	101.3	102.2	7.55	7.03	10.7	6.56	5.65	-1.5
Germany	+ 70.7	Nov	− 4.5	Nov	− 0.4	− 0.1	98.4	99.2	2.25	2.10	3.18	1.96	1.68	-2.5
Italy	+ 6.9	Nov	− 1.7	Oct	− 0.2	+ 0.2	72.3	72.9	2,228	2,076	3,151	1,936	1,668	-1.4
Japan	+ 72.9	Nov	+ 89.9	Nov	+ 2.1	+ 2.2	127.7	142.8	134	116	189	116	–	-6.4
Netherlands	+ 20.2	Nov	+ 11.1	Q3	+ 3.6	+ 3.7	97.6	98.4	1.15§	1.07	1.63	–	0.86	1.1
Spain	− 38.4	Oct	− 14.1	Oct	− 2.5	− 2.3	74.1	74.6	191	178	271	166	143	nil
Sweden	+ 12.5	Dec	+ 6.3	Nov	+ 2.6	+ 2.5	75.5	79.2	10.60	9.55	15.0	9.22	7.94	3.8
Switzerland	+ 1.0	Dec	+ 25.4	Q3	+10.0	+10.1	112.0	107.8	1.69	1.65	2.40	1.47	1.27	na
United States	−434.0	Nov	−430.7	Q3	− 4.0	− 4.1	124.4	114.3	–	–	1.41	0.87	0.75	0.6
Euro area	+ 32.6	Nov	− 24.5	Nov	− 0.2	nil	78.2	80.1	1.15	1.07	1.63	–	0.86	-1.2
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 11.1	Nov	+ 8.5	Nov	na	na	78.0	78.3	6.90	6.38	9.75	5.99	5.16	3.7
Greece	− 7.7	Oct	− 7.2	Oct	na	na	57.4	57.6	395	365	559	344	296	0.2
Iceland	− 0.2	Nov	− 0.7	Q3	na	na	na	na	103	85.3	146	89.8	77.4	-0.2
Ireland	+ 31.6	Nov	− 1.5	Q2	na	na	86.9	88.5	0.91	0.84	1.29	0.79	0.68	3.2
Luxembourg	− 2.8	Nov	+ 1.2	Q2	na	na	98.8	99.5	46.8	43.3	66.2	40.7	35.0	5.3
New Zealand	+ 0.4	Dec	− 0.2	Q3	na	na	82.4	81.5	2.41	2.25	3.41	2.09	1.80	1.3
Norway	+ 25.5	Dec	+ 24.0	Nov	na	na	97.8	93.6	9.08	8.78	12.8	7.89	6.80	14.3
Portugal	− 13.9	Oct	− 10.5	Oct	na	na	89.1	89.7	233	215	329	202	174	-1.7

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †1990=100, Bank of England. ‡OECD estimate. §Now using euro only.

Text refers only to the first 16 countries listed

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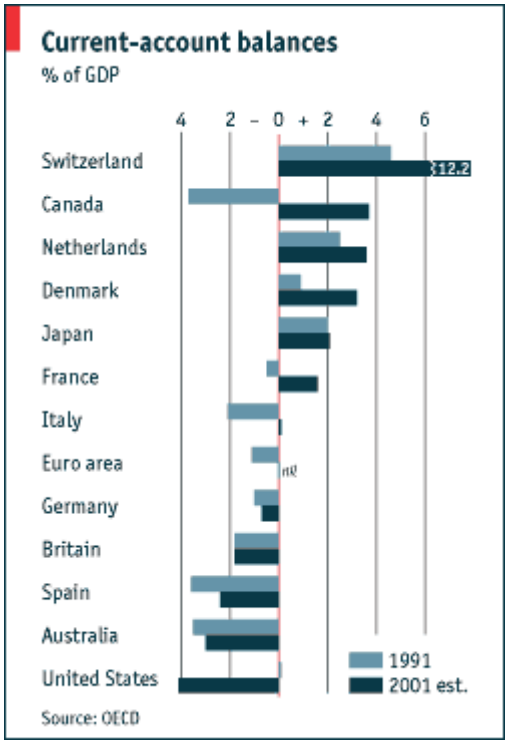
Current-account balances

Feb 7th 2002
From The Economist print edition



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Overview

Feb 7th 2002
From The Economist print edition

In **Argentina**, the government's decision to devalue the peso is already affecting consumer prices, which are rising at an annual rate of 0.6%, after falling by 1.5% in the year to December. Prices of imported goods have jumped. The UN's economic commission for Latin America has warned of the risk of hyperinflation.

Inflation seems to be picking up in **Turkey**. Consumer-price inflation jumped to 73.2% in the year to January, a marked acceleration from the recent low of 33.4% just under a year ago.

In the **Philippines**, inflation is falling rather than rising. Consumer-price inflation dropped to a 21-month low of 3.8% in the year to January, raising hopes that the central bank will cut interest rates when it meets next week.

In December **Indonesia's** 12-monthly trade surplus narrowed to $25.1 billion; **Malaysia's** fell to $14.0 billion.

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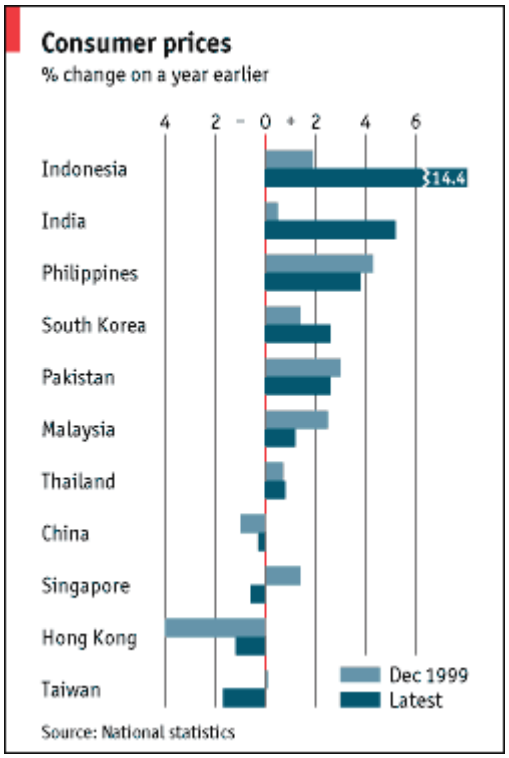
Consumer prices

Feb 7th 2002
From The Economist print edition

Consumer-price inflation has followed different paths among emerging Asian economies. In four of them—China, Singapore, Hong Kong and Taiwan—prices fell in the year to December 2001. Hong Kong has had deflation for three years in a row, largely as a result of its fixed exchange rate against the dollar. At the other extreme, Indonesia, where prices rose by 14.4% in the year to January, has the third-highest inflation rate among all the countries tracked by *The Economist*.



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Economy

Feb 7th 2002
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	% change on year earlier						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 7.0	Q3	+ 8.7	Dec	– 0.3	Dec	+22.6	Dec	+20.5	2000	211.8	Nov
Hong Kong	– 0.3	Q3	– 7.1	Q3	– 1.2	Dec	–11.2	Dec	+ 8.8	Q3	111.2	Dec
India	+ 5.3	Q3	+ 0.9	Nov	+ 5.2	Dec	– 5.8	Dec	– 0.7	Q3	46.4	Jan
Indonesia	+ 3.5	Q3	+ 3.2	Q2	+14.4	Jan	+25.1	Dec	+ 4.0	Q3	27.3	Dec
Malaysia	– 1.3	Q3	– 4.4	Nov	+ 1.2	Dec	+14.0	Dec	+ 7.4	Q3	30.5	Dec
Philippines	+ 3.8	Q4	– 5.0	Nov	+ 3.8	Jan	+ 3.4	Nov	+ 5.0	Oct	12.6	Nov
Singapore	– 7.0	Q4	–22.1	Dec	– 0.6	Dec	+ 5.2	Dec	+22.1	Q3	75.8	Dec
South Korea	+ 1.8	Q3	+ 3.3	Dec	+ 2.6	Jan	+ 9.5	Dec	+ 9.9	Nov	102.8	Dec
Taiwan	– 4.2	Q3	– 6.1	Dec	– 1.7	Jan	+15.7	Dec	+16.2	Q3	122.2	Dec
Thailand	+ 1.5	Q3	+ 1.3	Dec	+ 0.8	Jan	+ 2.5	Dec	+ 6.1	Nov	32.4	Dec
Argentina	– 4.9	Q3	–18.3	Dec	+ 0.6	Jan	+ 6.3	Dec	– 6.8	Q3	14.6	Dec
Brazil	+ 0.3	Q3	– 2.0	Nov	+ 9.4	Dec	+ 3.3	Jan	–23.2	Dec	35.8	Dec
Chile	+ 2.6	Q3	– 1.9	Dec	+ 2.2	Jan	+ 1.4	Dec	– 1.7	Q3	14.2	Dec
Colombia	+ 1.0	Q3	– 4.3	Nov	+ 7.4	Jan	+ 0.5	Nov	– 1.2	Q3	10.3	Dec
Mexico	– 1.6	Q3	– 3.7	Nov	+ 4.4	Dec	– 9.7	Dec	–16.6	Q3	44.7	Dec
Peru	+ 1.7	Nov	– 4.2	Nov	– 0.8	Jan	– 0.1	Nov	– 1.4	Q3	8.8	Nov
Venezuela	+ 2.8	Q3	+ 7.9	Oct	+12.3	Dec	+13.0	Q3	+ 4.4	Q4	9.4	Nov
Egypt	+ 6.5	2000†	+ 9.4	2000†	+ 2.3	Oct	– 8.5	Sep	nil	Q3	13.3	Nov
Israel	– 2.7	Q3	– 9.6	Nov	+ 1.4	Dec	– 7.1	Dec	– 3.6	Q3	22.9	Dec
South Africa	+ 0.1	Q3	+ 4.1	Nov	+ 4.6	Dec	+ 4.1	Dec	+ 0.3	Q3	6.0	Dec
Turkey	– 7.1	Q3	–13.9	Nov	+73.2	Jan	–11.3	Nov	+ 0.9	Oct	18.9	Dec
Czech Republic	+ 3.2	Q3	+ 6.6	Nov	+ 4.1	Dec	– 3.1	Dec	– 2.6	Q3	14.3	Dec
Hungary	+ 3.7	Q3	+ 1.6	Dec	+ 6.8	Dec	– 1.6	Dec	– 0.5	Dec	10.8	Dec
Poland	+ 0.8	Q3	– 4.8	Dec	+ 3.6	Dec	–11.7	Dec	– 7.0	Dec	25.7	Dec
Russia	+ 4.9	Q3	+ 2.6	Dec	+18.8	Dec	+52.3	Nov	+41.5	Q3	32.5	Dec
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.3	2001†	+ 7.7	Sep	+ 2.6	Dec	– 1.0	Nov	+ 0.3	2001†	3.6	Dec
Saudi Arabia	+ 4.5	2000§	na		nil	Nov	+50.9	2000	+15.6	2000	17.6	Dec

*Excluding gold, except Singapore; IMF definition. †Year ending June. § Economist Intelligence Unit estimate.

Text refers only to the first 25 countries listed

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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Financial markets

Feb 7th 2002
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Feb 6th		Dec 31st 2000	
	Feb 6th	year ago	Feb 6th	% p.a.		one week	in local currency	in $ terms
China	8.19	8.28	11.6	na	1,549.0	+6.3	– 29.3	– 29.3
Hong Kong	7.80	7.80	11.0	1.96	10,592.4	–1.5	– 29.8	– 29.8
India	48.7	46.4	68.8	6.71	3,427.4	+3.9	– 13.7	– 17.2
Indonesia	10,325	9,646	14,604	17.57	446.2	+0.4	+ 7.2	+ 0.4
Malaysia	3.80	3.80	5.37	3.28	715.2	+0.7	+ 5.2	+ 5.2
Philippines	51.3	48.6	72.5	8.13	1,367.5	+4.6	– 8.5	– 10.7
Singapore	1.83	1.75	2.59	0.94	1,748.6	–0.4	– 9.2	– 14.1
South Korea	1,312	1,268	1,855	4.60	741.6	–1.1	+ 47.0	+ 41.7
Taiwan	35.0	32.2	49.5	2.60	5,926.1	+2.0	+ 24.9	+ 18.2
Thailand	43.8	42.6	61.9	2.38	348.2	+2.3	+ 29.3	+ 27.6
Argentina	2.02**	1.00	2.86	na	471.3	+3.8	+ 13.0	– 44.3
Brazil	2.42	2.01	3.42	19.05	12,747.5	+1.7	– 18.3	– 34.2
Chile	689	562	974	5.40*	5,253.5	–0.3	+ 7.9	– 10.1
Colombia	2,255	2,240	3,189	11.15	1,128.2	–1.3	na	na
Mexico	9.13	9.70	12.9	8.15	6,865.1	+1.7	+ 21.5	+ 27.8
Peru	3.49	3.53	4.93	2.48	1,267.9	nil	+ 4.9	+ 6.2
Venezuela	770	702	1,089	19.23	6,223.9	–0.3	– 8.4	– 16.7
Egypt	4.63	3.89	6.55	7.23	5,128.1	+6.5	– 33.1	– 43.7
Israel	4.63	4.14	6.55	2.22	436.9	+1.7	– 11.7	– 22.9
South Africa	11.5	7.87	16.2	9.45††	10,685.2	+4.7	+ 28.3	– 15.3
Turkey	1,328,000	677,520	1,878,323	54.00	12,257.4	–2.2	+ 29.9	– 34.4
Czech Republic	36.7	37.1	51.8	4.30	413.4	–0.5	– 13.6	– 11.3
Hungary	281	285	398	8.73	7,769.5	–1.5	– 1.0	– 0.7
Poland	4.23	4.06	5.98	10.82	15,529.8	–1.4	– 13.0	– 15.0
Russia	30.8	28.5	43.5	25.00	292.8†	+2.8	+119.3	+104.3
EMF (MSCI)‡	1.00	1.00	1.41	na	327.4	+1.3	na	– 1.9
EMBI+§	1.00	1.00	1.41	na	205.9	+0.8	na	+ 2.0

*Inflation adjusted. †In $ terms. ‡Emerging Markets Free. §J.P. Morgan Chase's Emerging Markets Bond Index Plus. **Fixed official rate 1.40.
Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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